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45 CFR Parts 261, et al.

Reauthorization of the Temporary Assistance for Needy Families Program; Interim Final Rule

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Administration for Children and Families

45 CFR Parts 261, 262, 263, 265

RIN 0970–AC27

Reauthorization of the Temporary Assistance for Needy Families Program

AGENCY: Administration for Children and Families (ACF), Department of Health and Human Services (HHS).

ACTION: Interim final rule with request for comments.

SUMMARY: This interim final rule implements the statutory changes enacted in the reauthorization of the Temporary Assistance for Needy Families (TANF) program in the Deficit Reduction Act of 2005. This legislation reauthorizes the TANF program through fiscal year (FY) 2010 with a renewed focus on work, program integrity and strengthening families through healthy marriage promotion and responsible fatherhood. The interim final rule addresses the work and program integrity changes of the new law.

DATES: *Effective Date:* June 29, 2006.

Comment Date: Comments due on or before August 28, 2006.

ADDRESSES: You may submit your comments in writing to the Office of Family Assistance (OFA), Administration for Children and Families, 5th Floor East, 370 L'Enfant Promenade, SW., Washington, DC 20447 or hand deliver to OFA/ACF, 5th Floor East, 901 D St., SW., Washington, DC 20447. You may download an electronic version of the interim final rule at *http://www.regulations.gov* and may download a copy and transmit written comments electronically via the Internet at: *http://www.regulations.acf.hhs.gov.*

FOR FURTHER INFORMATION CONTACT: Robert Shelbourne, Director, Division of State TANF Policy, Office of Family Assistance, ACF, at (202) 401–5150.

SUPPLEMENTARY INFORMATION:

I. Comment Procedures

Instructions: All comments received, including any personal information provided, will be posted without change to *http://www.regulations.acf.hhs.gov.* Also, comments will be available for public inspection Monday through Friday 8:30 a.m. to 5 p.m. at 901 D St., SW., 5th Floor, Washington, DC.

We will not consider comments received beyond the 60-day comment period in modifying the interim final rule. To make sure your comments are fully addressed, we suggest the following:

- Be specific;
- Address only issues raised by the rulemaking discretion exercised in the interim final rule, not the changes to the law itself;
- Explain reasons for any objections or recommended changes;
- Propose appropriate alternatives; and
- Reference the specific section of the interim final rule being addressed.

II. Background

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) (Pub. L. 104–193) created the Temporary Assistance for Needy Families (TANF) block grant that fundamentally transformed welfare from a cash benefits program to a program focused on work and temporary assistance. Under TANF, adults receiving assistance are expected to engage in work activities and develop the capability to support themselves before their time-limited assistance runs out. States are required to assist recipients in making the transition to employment. Also, they are expected to meet work participation rates and other critical program requirements in order to maintain their full Federal funding and avoid penalties.

The PRWORA legislation also dramatically changed intergovernmental relationships, giving States and Tribes broad flexibility to set eligibility rules and decide what types of benefits and services to provide clients. States and Tribes have used this flexibility to try new, far-reaching initiatives that effectively addressed the needs of families. PRWORA limited Federal regulatory authority, but added new responsibility for tracking State performance and imposing penalties when States fail to comply with program requirements.

TANF has been a truly remarkable example of a successful Federal-State partnership. Millions of parents have left welfare for work, reducing the TANF rolls by nearly 60 percent, from about 4.4 million families in August 1996 to just 1.9 million families in September 2005. But the decline in the caseload is just part of the story. During this period there were also great improvements in a range of outcomes for low-income families and children:

- The percentage of never-married mothers who work outside the home for wages increased nearly 30 percent, from 49.3 percent in 1996 to 63.1 percent in 2004.
- The child poverty rate fell from 20.5 percent in 1996 to 17.8 percent in 2004, reflecting 1.4 million fewer children living in poverty.
- During this same period, the poverty rate among African American children declined from 39.9 percent to 33.2 percent, and the poverty rate among Hispanic children declined from 40.3 percent to 28.9 percent.
- Although the poverty rate has increased some since 2000 as a result of the most recent recession, the surge in job creation over the past two years portends favorably for renewed improvement in poverty rates.

But, if we are to succeed in achieving the full purposes of TANF, there is still much to be done. Even with the dramatic results States have achieved, there are still far too many clients that are denied the opportunities of work and preparation for work. In FY 2005, only 30 percent of those required to work were participating in work activities for sufficient hours to count toward the work participation rate. States have been less effective in placing clients with multiple barriers in work, including those with mental health issues, addiction, developmental or learning disabilities, limited English proficiency, and those subject to domestic violence. While the average wages of clients entering the workforce are above the minimum wage, they are still too low to ensure family well-being. More effective models of post-employment supports that lead to career development and wage progression are needed. Our clients also need programs that sustain and keep families together and programs that enable low-income, non-custodial fathers to help their families financially.

Justification for Interim Final Rule

The Administrative Procedure Act requirements for notice of proposed rulemaking do not apply to rules when the agency finds that notice is impracticable, unnecessary, or contrary to the public interest. We find proposed rulemaking impracticable and contrary to the public interest because it would fragment the implementation of the Deficit Reduction Act's (DRA) (Pub.L. 109–171) work requirements. The DRA clearly states that implementation of certain work requirement changes will be effective October 1, 2006. In particular, the statute strengthens the existing work requirements by extending work participation requirements to families with an adult receiving assistance in a separate State program and recalibrating the caseload reduction credit by updating the base year from FY 1995 to FY 2005. The law

also directs the Secretary of Health and Human Services to define work activities and determine who is a work-eligible individual, and these provisions are critical to the timely implementation of work requirements. In particular, without Federal definitions for work activities, States could define some activities so broadly that they render the new work provisions meaningless, thereby delaying implementation of meaningful reform. Moreover, such a practice would perpetuate existing disparities in State definitions and undermine the equitable treatment of States. In addition, States would be required to establish work participation verification procedures regarding activities that would not yet be defined in regulation. Therefore, States might have to revise their procedures substantially once final regulations were published. Thus, issuing regulations regarding all aspects of work requirements simultaneously is necessary to implement the intent of the law and promote the public interest. Under an interim final rule, States would know how to plan their programs and take necessary steps to implement the new requirements.

Further, in the Deficit Reduction Act of 2005, Congress explicitly allows HHS to issue these regulations on an interim final basis. Thus, the policies reflected in this interim final rule are effective immediately. We will consider all germane comments received during the comment period. With one exception, States must comply with these requirements by October 1, 2006, or be subject to potential penalties during FY 2007. The exception relates to the new penalty created by the Deficit Reduction Act of 2005 for States that fail to establish and maintain procedures to verify reported work participation data. While States are required by the statute and this rule at § 261.63 to submit a Work Verification Plan by September 30, 2006, we will hold States accountable for failure to maintain adequate internal controls and work verification procedures only for conduct that occurs after October 1, 2007.

III. The Deficit Reduction Act of 2005

On February 8, 2006, the President signed the Deficit Reduction Act of 2005 (Pub. L. 109–171). It includes provisions to reauthorize TANF and build on this program's success. The new law addresses the needs of families by maintaining the program's overall funding and basic structure, while focusing increased efforts on building stronger families through work, job advancement, and research on healthy marriage and responsible fatherhood programs. It retains funding at $16.5 billion each year for block grants to States and Tribes; $319 million a year through FY 2008 for supplemental grants to certain States with high population growth and historically low welfare payments; and $2 billion over five years for the Contingency Fund for needy States. It also creates a $150 million a year research, demonstration, and technical assistance fund for competitive grants to strengthen family formation, promote healthy marriages, and support responsible fatherhood.

The Deficit Reduction Act of 2005 maintains State flexibility and many provisions of PRWORA, but includes important changes to improve the effectiveness of the program. The law strengthens work participation requirements by recalibrating the caseload reduction credit so that States only receive credit for additional caseload reductions after FY 2005. Families in separate State programs for whom funds are claimed to meet the ''maintenance of effort'' (MOE) requirements are now included in the work participation rate calculation and other data collection requirements. The law also requires the Secretary to provide additional direction and oversight on how to count and verify allowable work activities, to clarify who is a work-eligible individual and to ensure that State internal control procedures will result in accurate and consistent work participation information. The Deficit Reduction Act of 2005 also creates a new penalty for States that fail to establish and maintain procedures to verify reported work participation data. This interim final rule implements these statutory changes and the next phase of welfare reform by helping more low-income families enter the workforce and succeed at work.

Under PRWORA, we interpreted the limitation on Federal authority to allow us to regulate in two situations: (1) Where Congress explicitly directed the Secretary to regulate; and (2) where Congress charged HHS with enforcing penalties. In the latter situation, we promulgated regulations to set out the criteria we would use in carrying out our authority to assess penalties. The Deficit Reduction Act of 2005 does not alter the general restriction on Federal regulatory authority at Section 417 of the Social Security Act, and so we are continuing this overall policy. However, the law did explicitly direct HHS to regulate on certain aspects of the work participation requirements.

The TANF final rule (64 FR 17720, April 12, 1999) reflects PRWORA's strong focus on moving recipients to work and self-sufficiency, and on ensuring that welfare is a short-term, transitional experience, not a way of life. The rule encourages and supports State flexibility, innovation, and creativity while holding States accountable for moving families toward self-sufficiency. In developing this interim final rule, we have sought to implement the new requirements of the Deficit Reduction Act of 2005 in a way that does not impinge on a State's ability to design effective and responsive programs. Indeed, most States have demonstrated a tremendous commitment to the TANF work goals and objectives, using creativity and ingenuity to help families succeed.

Nevertheless, some observers, and the Government Accountability Office (GAO) in particular, have noted that the flexibility provided to States to define work activities for themselves has led to inconsistent definitions across States as well as inconsistent measurement of work participation. In their 2005 report ''Welfare Reform: HHS Should Exercise Oversight to Help Ensure TANF Work Participation Is Measured Consistently Across States'' (GAO–05–821), GAO noted that the wide range of work activity definitions used across States makes it difficult to compare work participation across States. Similarly, some States have used this flexibility to authorize a wide variety of activities to advantage themselves compared to other States. In particular, some activities included by some States under some work activities do not appear to effectively address barriers to work or enhance the job readiness of clients.

As a result of concerns about the inconsistency of work measures among States, the Deficit Reduction Act of 2005 requires us to issue this regulation to define each work activity category. As we discuss in detail later, under our definitions States retain the flexibility to engage clients in appropriate activities, tailored to their needs. But we restrict certain practices that some States have used under our prior rules, particularly those activities that do not improve job skills or enhance an individual's employability.

We also provide guidance to States on our expectations for verifying and documenting actual hours of participation. We do this through preamble language with examples, as well as through general regulatory language that outlines internal control principles that derive from government auditing standards. The basic premise of this approach is that public officials are accountable for establishing and maintaining effective internal control systems to ensure that laws and regulations are followed; that program

goals and objectives are met; that resources are safeguarded; and that reliable data are obtained, maintained, and fairly disclosed. Under this principle, when a State reports hours of participation for a family, it is reasonable to expect that there is supporting documentation that the reported activities are real and were actually performed for the hours claimed. We also recognize the need to be careful in establishing documentation requirements so that we do not return to an eligibility-focused culture, where paperwork receives more attention than moving individuals into self-sufficiency.

Unsubsidized employment is the primary goal of TANF. A growing body of evidence suggests that more TANF recipients may be working than many believe, and that State-reported TANF data on reasons for case closure may be persistently understating the role of employment. More specifically, States report that less than 20 percent of case closures are due to employment, while nearly half of all cases are closed due to reasons such as ''failure to cooperate,'' ''voluntary closure,'' or ''other'' unspecified reasons. In contrast, an HHS-funded synthesis report of welfare leaver studies conducted by the Urban Institute found that somewhat over half of families leaving welfare do so as a result of employment (*Final Synthesis Report of Findings from ASPE ''Leavers'' Grants,* November, 2001). Many closures that are, in fact, due to employment are coded by the States as ''failure to cooperate'' or as some other category because at the point of closure, the State agency often is unaware that the client became employed. This undercount in administrative data may occur because some recipients obtain employment, but do not immediately notify the TANF agency. As a result, individuals miss out on other employment-supporting benefits for which they may be eligible and States miss families that they could count toward the participation rates.

Part of the success of State efforts is that many recipients want to work and get jobs on their own. The new requirements set forth in the Deficit Reduction Act of 2005 will ensure that TANF agencies know whether their clients are employed so that they can properly address the needs of families moving to self-sufficiency and count them in the work participation rates. The new requirements will also help ensure that TANF agencies know whether families that left welfare were employed prior to case closure so that these families can be counted toward the work participation rate.

New hires information contained in the National Directory of New Hires (NDNH) may help solve these problems. The NDNH information can help identify those who are employed but whose employment is unknown to the TANF agency. We will continue to work with State agencies to provide the NDNH information and to identify effective verification and documentation practices. If State TANF agencies use the NDNH regularly and base their participation rate data on verified employment matches, they will improve the accuracy and consistency of information on which work participation rates are calculated.

In keeping with the President's New Freedom Initiative, we encourage States to make every effort to engage individuals with disabilities in work activities. Disabled individuals on TANF caseloads are capable of participating in productive work activities and deserve an opportunity to become self-sufficient through work. Under the TANF statute, such families are included in the work participation rate calculation. It is important that every effort is made to serve the full range of TANF recipients that can work and benefit from work activities and supports. States are encouraged to explore the capabilities of all TANF recipients to learn what they can do rather than focusing on their limitations. States may explore new ways to implement work activities like specialized work experience sites that help families attain the necessary work skills to improve their ability to obtain employment. In fact, in the definition of ''work-eligible individual'' in § 261.2, we encourage States to work with parents who receive Supplemental Security Income (SSI) and whose children are TANF recipients by giving them the option to include such families when they meet participation requirements. We are hopeful this increased State flexibility will give States the incentive to broaden their efforts in working with disabled individuals to give them every opportunity to enter the workforce.

Of course, States must continue to comply with the civil rights laws, including those enumerated at 408(d) of the Social Security Act, when implementing the new work requirements. Section 408(d) expressly states that any program or activity receiving Federal TANF funds is subject to: (1) The Age Discrimination Act of 1975; (2) Section 504 of the Rehabilitation Act of 1973 (Section 504); (3) the Americans with Disabilities Act of 1990 (ADA); and (4) Title VI of the Civil Rights Act of 1964. These laws are also referenced in the regulations at 45 CFR 260.35. For information about the application of civil rights laws in the context of TANF, visit the Office for Civil Rights (OCR) Web site at *http://www.hhs.gov/ocr.* Among other things, the Web site contains OCR guidance entitled *Civil Rights Laws and Welfare Reform—An Overview and Technical Assistance for Caseworkers on Civil Rights Law and Welfare Reform* and *Prohibition Against Discrimination on the Basis of Disability in the Administration of TANF* and other information on how to contact OCR headquarters and regional offices for further information and technical assistance. Additional information, including fact sheets and discrimination complaint forms, is also located on the OCR Web site or may be obtained by calling OCR toll free at 800–368–1019, TDD 800–537–7697.

IV. Regulatory Provisions

The Deficit Reduction Act of 2005 requires relatively modest changes to existing TANF regulations at 45 CFR Parts 261, 262, 263 and 265. Thus, this interim final rule reflects primarily the changes to the original TANF rules required by the new statutory provisions. In the preamble, we discuss only the regulatory sections that are being revised or newly established. We do not make any changes to either 45 CFR part 260, General TANF Provisions or to 45 CFR part 264, Other Accountability Provisions.

Note that we use the term ''we'' throughout the regulatory text and preamble. The term ''we'' means the Secretary of the Department of Health and Human Services or any of the following individuals or agencies acting on his behalf: the Assistant Secretary for Children and Families, the Regional Administrators for Children and Families, the Department of Health and Human Services, and the Administration for Children and Families. Likewise, the term ''Act'' refers to the Social Security Act, as amended. We use the term ''The Deficit Reduction Act of 2005'' (Pub. L. 109–171) when we refer to the new law. States, the Territories, and the District of Columbia are all subject to the TANF requirements, but for the ease of the reader, hereinafter, a reference to States means this entire group. Tribal TANF programs are not affected by this rule; the Deficit Reduction Act of 2005 does not amend section 412 of the Social Security Act that authorizes Tribal TANF programs.

For the convenience of readers, where we make major changes to a regulatory section or to a subpart, we republish the

section or subpart in its entirety, rather than just the changes. This makes the provisions easier to understand and gives context to the regulatory changes.

Part 261—Ensuring That Recipients Work

Section 261.2 What definitions apply to this part?

Under the original TANF rule, we chose not to define work activities to provide maximum flexibility to States so they could design and carry out the welfare reform programs that best met the individual needs to help families find work and become self-sufficient. We simply listed the 12 work activities in 45 CFR 261.30 in the order they appear in the Act. However, we indicated in the preamble of the final TANF rule, that we were ''concerned that different TANF definitions [of work activities] could affect the vulnerability of States to penalties for failure to meet the participation rate.'' As we noted, ''to the extent possible, we want to ensure an equitable and level playing field for the States.'' We also explained that we would ''carefully assess the types of programs and activities States develop'' and ''if necessary at some time in the future, we will initiate further regulatory action.''

We are now convinced that the flexibility we initially allowed States to define work activities results in inconsistent work participation measurement and that disparities in State definitions undermine the principle of equitable treatment. For example, several States count job search, job readiness activities, and vocational educational training as part of a work experience or community service program. In some instances, it appears that States integrated these activities into work experience or community service to avoid various limitations on some TANF work activities, such as the statutory six-week limitation on counting job search and job readiness assistance. Some States also count participation in otherwise unallowable educational activities as part of an allowable TANF work activity. Thus, defining work activities is necessary to maintain the integrity of the TANF work participation requirements. Unless we define the work activities, States with narrow definitions would be at a disadvantage in meeting the participation requirements compared to States with broader definitions.

Furthermore, the Deficit Reduction Act of 2005 requires the Secretary to promulgate regulations to ensure consistent measurement of work participation rates. The law specifically requires us to determine whether an activity of a recipient of assistance may be treated as a work activity. We are defining each of the allowable work activities to promote consistency in the measurement of work participation rates and thus treat States fairly.

Section 407(d) of the Social Security Act specifies 12 separate and distinct activities. Thus, we have attempted to draft definitions that are, as far as possible, mutually exclusive from one another. Because the list of countable activities is provided by statute, we do not have the regulatory authority to add additional activities. Our definitions follow the order that the work activities are listed in § 261.30 of this part and section 407(d) of the Social Security Act for ease of reference when referring to the nine core work activities that count for the first 20 hours of required work and the three activities that can only count as participation after the 20-hour requirement is met.

We would like to emphasize that these definitions delineate what constitutes each activity for the work participation rate but they in no way change the requirement that individuals must participate for a specified number of hours to count in the participation rate. Generally, that requirement is for an individual to participate for an average of 30 hours per week in the month with the exception that a single custodial parent of a child under six must participate for an average of only 20 hours per week in a month. To count in the two-parent rate, the parents must participate for a combined total of at least 35 or 55 hours, depending on whether they receive federally funded child care. States continue to have the flexibility to assign an individual to a combination of activities, for example blending school and work or training and work or job search and community service, to reach the hours needed to count a family in the work participation rate. Please refer to the regulations in subpart C of part 261 and the preamble explanation of that subpart for more a more detailed discussion of the hours and activities requirements.

Below, we discuss the rationale for the definitions that are included in § 261.2.

Unsubsidized employment means full- or part-time employment in the public or private sector that is not subsidized by TANF or any other public program.

The determination of whether or not employment is subsidized depends on whether the employer, rather than the recipient, receives a subsidy. If an employer receives a direct subsidy for hiring a recipient from TANF or other public funds, that recipient would be considered to be in subsidized public or private sector employment. This definition does not apply to recipients whose employers claim a tax credit for hiring economically disadvantaged workers. While such tax credits are designed to foster the employment of low-income workers, traditionally they have not been treated as ''subsidized employment'' in the context of welfare.

All TANF recipients in unsubsidized employment are, by definition, receiving a subsidy—their TANF assistance grant. The receipt of this grant, however, does not constitute subsidized employment, as long as the employer receives no direct subsidy for employing the recipient. Recipients in unsubsidized employment also may receive work-related subsidies, such as child care, transportation, and other support services.

Self-employment may count as unsubsidized employment. Self-employment may include, but is not limited to, domestic work and the provision of child care. As we explain in the preamble to § 261.60, a State may not count more hours toward the participation rate for a self-employed individual than the number derived by dividing the individual's self-employment income (gross income less business expenses) by the Federal minimum wage.

We are defining both *subsidized private sector employment* and *subsidized public sector employment* as employment for which the employer receives a subsidy from TANF or other public funds to offset some or all of the wages and costs of employing a recipient. Subsidized employment differs from unsubsidized employment in that the employer receives a subsidy. It differs from work experience in that the participant is paid wages and receives the same benefits as a non-subsidized employee who performs similar work.

There are several ways to operate a subsidized employment program. One approach is to use TANF funds that would otherwise be paid as assistance to reimburse some or all of an employer's costs for the wages, benefits, and/or the additional costs of employment-related taxes and insurance. (Under the Aid to Families with Dependent Children (AFDC) program, this approach was called ''work supplementation'' or ''grant diversion.'')

A second model is one in which a third party acts as the employer of record during the trial period, like a temporary staffing agency. For example, a private, for-profit organization may

contract with a welfare agency and serve as the employer of record while the participant works for a private-sector company for a trial period. The organization receives a fee from the TANF or other public agency (and employers) to cover the participant's salary and support services, including on-site follow-up for both employers and employees. The total amount of the payment to the private, for-profit organization depends on how successful it is in placing and keeping employees in jobs.

Supported work for individuals with disabilities, as defined under the Rehabilitation Act of 1973 (29 U.S.C. 705(35)), also could be counted as subsidized employment. Supported work for individuals with disabilities means work in an integrated setting (*i.e.*, where people with and without disabilities work in the same place) for wages consistent with those paid to non-disabled workers with similar job functions. The workers with disabilities may receive individualized services such as, but not limited to, transportation, family support, or additional supervision. To the extent that supported work also includes intensive on-site training activities, it may be counted as on-the-job training, discussed below.

Regardless of the approach, the employer is subject to the requirements of the Fair Labor Standards Act (FLSA) and, as a result, must pay the participant wages that equal or exceed the applicable Federal or State minimum wage. We recommend that States generally limit the duration of subsidized employment programs to six to twelve months; however, longer durations may be appropriate for supported employment of individuals with disabilities, as long as they are justified by an individualized needs assessment.

During this trial period in which the costs of employment are being subsidized, the employer should provide necessary training, guidance, and direction to an employee. At the end of the subsidy period, the employer is expected to retain the participant as a regular employee without receiving a subsidy. States should not allow employers to recycle TANF recipients in subsidized employment slots, thereby reducing their competitive labor costs.

We considered whether to regulate the rate of reimbursement to employers and the duration of a subsidized employment position. We decided against specifying limits because States should have the flexibility to design a program that meets their needs and the needs of the individuals they serve. However, the goal of subsidized employment should be to prepare participants for and move them into unsubsidized employment.

Receipt of employment subsidies provided through the tax code, including Federal tax credits, such as the Work Opportunity Tax Credit (WOTC) and the Welfare-to-Work Tax Credit (WWTC), does not make subsidized employment of an otherwise unsubsidized job for purposes of this definition. These tax credits subsidize employers who hire welfare recipients or other hard-to-employ groups. TANF agencies, however, may not know whether employers use such tax credits and employers may not file for them until well after they have hired recipients. We consider participants supported by Federal tax credits only to be in ''unsubsidized employment.''

Subsidized private or public sector employment also does not include ''on-the-job training'' programs, where employers are subsidized to offset the costs of training. (See the discussion of on-the-job training below.)

Work experience (including work associated with the refurbishing of publicly assisted housing) if sufficient private sector employment is not available means a work activity, performed in return for welfare, that provides an individual with an opportunity to acquire the general skills, training, knowledge, and work habits necessary to obtain employment. The purpose of work experience is to improve the employability of those who cannot find unsubsidized employment. This activity must be supervised by an employer, work site sponsor, or other responsible party daily. Work experience programs are sometimes called ''workfare'' because participants continue to receive their TANF grant.

Some existing State work experience programs include activities that fall outside this definition. For example, several States count job search, job readiness activities, and vocational educational training as part of a work experience program. In some instances, it appears that States integrated these activities into work experience to avoid various limitations, such as the six-week limitation on counting job search and job readiness assistance. We will not permit these practices under this interim final rule.

Work experience participants continue to receive their TANF grant while they are taking part in work and training activities similar to those of paid employees. They do not receive wages or compensation. Nonetheless, they may be considered employees for the purpose of the Fair Labor Standards Act (FLSA). According to the Department of Labor's May 1997 guidance, ''How Workplace Laws Apply to Welfare Recipients,'' ''[w]elfare recipients in 'workfare' arrangements, which required recipients to work in return for their welfare benefits, must be compensated at the minimum wage if they are classified as 'employees' under the Fair Labor Standard Act's (FLSA) broad definition.'' The FLSA applies if there is an employment relationship between an employer and an employee. But the FLSA uses a broader definition than is often used for tax or unemployment purposes. To ''employ'' under the FLSA, means to ''suffer or permit to work.'' If recipients engaged in work experience activities are ''employees'' under the FLSA definition, they must be compensated at the applicable minimum wage. The FLSA's overtime pay (for over 40 hours in a work week), child labor, and recordkeeping requirements also apply.

The TANF assistance and benefits that these work experience participants receive are not considered wages for Social Security purposes, nor are they considered taxable income for purposes of the Federal income tax or the Earned Income Tax Credit. However, a State might consider a participant in work experience to be an employee of the State for purposes of workers' compensation coverage.

We considered whether to regulate the duration of a traditional work experience position. We decided against specifying limits. States should have the flexibility to design programs that meet both their needs and those of the individuals they serve. However, the goal of work experience should be to prepare participants for and move them into unsubsidized employment or other program activities that can help in this transition.

On-the-job training (OJT) means training in the public or private sector that is given to a paid employee while he or she is engaged in productive work and that provides knowledge and skills essential to the full and adequate performance of the job. On-the-job training must be supervised by an employer, work site sponsor, or other responsible party daily.

In this type of activity, States may subsidize the employer to offset the cost of the training provided to the participant. Upon satisfactory completion of the training, we expect the employer to retain the participant as a regular employee without receiving a subsidy.

As noted under the discussion of subsidized employment, ''supported employment'' as defined under the

Rehabilitation Act of 1973 (29 U.S.C. 705(35)), may be counted as OJT if it includes significant on-site training in the knowledge and skills essential to the full and adequate performance of the job. For example, a State Vocational Rehabilitation agency may provide a client with an onsite ''job coach'' who teaches job skills in the context of productive work. If ''supported employment'' includes an employer subsidy and other supportive services but does not include on-site training, it should be counted as subsidized employment.

We defined OJT as a component of employment, whether unsubsidized or subsidized. However, some elements of training may involve specialized preparation to prepare participants for a specific position with an employer and do not constitute employment. Such training may be more akin to vocational educational training. While we have tried to define work activities so that they do not overlap, OJT combines some elements of subsidized employment, vocational education and other forms of training. We are interested in receiving comments about whether we should broaden the definition beyond paid employment to include other aspects of training.

Job search and job readiness assistance means the act of seeking or obtaining employment, preparation to seek or obtain employment, including life skills training, and substance abuse treatment, mental health treatment, or rehabilitation activities for those who are otherwise employable. Job search and job readiness assistance participants should be supervised on an ongoing basis no less frequently than daily. Readers should refer to § 261.34 (which is not revised in this interim final rule) for a discussion of the time limitations that apply to this activity.

''Job search and job readiness assistance'' is a single component for Federal participation standards. The ''job search'' aspect of this component is largely self-explanatory and we define it as ''the act of seeking or obtaining employment,'' which should encompass all reasonable job search initiatives. As such, ''job search'' includes making contact with potential employers, whether by telephone, in person or via the Internet, to learn of suitable job openings, applying for vacancies, and interviewing for jobs.

Our definition of ''job readiness assistance'' comprises two types of activities. The first is preparation necessary for an individual to seek or obtain employment. This includes activities such as preparing a resume or job application, training in interviewing skills, instruction in work place expectations (including instruction on appropriate attire and behavior on the job), and training in effective job seeking, as well as life skills training. The second is substance abuse treatment, mental health treatment, or rehabilitation activities for those who are otherwise employable. Such treatment or therapy must be determined to be necessary and certified by a qualified medical or mental health professional. Some individuals in the TANF caseload are capable of getting and keeping a job but for a substance abuse, mental heath, or other condition that treatment or rehabilitation activities would resolve. We have included these services as part of our definition to help such individuals make the transition from welfare to work.

As with other work activities, a State may only count an individual's actual hours of participation in substance abuse treatment, mental health treatment, or rehabilitation activities and must document those hours as required at §§ 261.60 and 261.61. If an individual does not have sufficient hours in substance abuse treatment, mental health treatment, or rehabilitation activities alone to count in the participation rate, he or she may still be counted in the calculation of the State's work participation rate by combining them with other allowable activities. Individuals in substance abuse treatment, mental health treatment, or rehabilitation activities are subject to the same hours requirements to count for participation that individuals in any other activities must meet. Please refer to §§ 261.31 and 261.32 for more details about the number of hours needed to count a family in the participation rates.

Our goal in incorporating substance abuse treatment, mental health treatment, and rehabilitative activities for those who are otherwise employable into this interim final rule is to ensure that States can meet the needs of all individuals in their caseloads struggling to escape welfare dependency. We are interested in receiving comments about our approach in this area.

For substance abuse treatment, mental health treatment or rehabilitation activities that are not part of job search and job readiness assistance, States should be advised that a portion of those activities may count toward the work participation rate. If a portion of substance abuse treatment, mental health treatment or rehabilitation service meets a common-sense definition of work, then the hours associated with that work activity may count under the appropriate work category, such as work experience. For example, a State may place an individual who is otherwise able to work but for the need to reinforce substance abuse treatment into a special program in which a single provider coordinates work and treatment in a halfway house environment. As part of that treatment program, the individual also fulfills assigned supervised, documented work responsibilities for the benefit of all the residents, such as preparing meals, housecleaning, or scheduling group activities. In that case, the State may report the hours the individual was in the work portion of the program, i.e., performing work that meets the requirements of these rules. The time the individual spent in the treatment component does not count in the work category.

Some States currently incorporate as part of job search and job readiness assistance programs that would fall outside our new definition. For example, at least one State incorporates activities ''that are essential to the health, safety and welfare of families,'' including activities associated with a child's dental checkups, immunization, and school attendance. Parenting skills training or participating in Head Start is part of the definition in more than one State. Another State includes personal care during recovery from a medical problem, bed rest, hospitalization, and activities that promote a healthier lifestyle, such as smoking cessation. These are valuable and important things for a family to address or may be medically appropriate, but they do not constitute work or direct preparation for work. Thus, these activities may not count as job search and job readiness assistance. Only programs that involve seeking and preparing for work can meet this definition.

Current State definitions of job search and job readiness also include one or more of the other eleven countable work activities. For example, one State lists remedial education and English as a Second Language (ESL) as part of job search and job readiness. These activities more closely fit our definition of job skills training directly related to employment or education directly related to employment and should be counted under those activities, as appropriate.

Some States have asked us what constitutes a week for the limitations on counting no more than six weeks per fiscal year of job search and job readiness assistance, no more than four of which may be consecutive. We believe that the most commonly understood and simplest way to answer this question is to use the ordinary

definition of a week: seven consecutive days. Whether the State starts counting an individual's participation on a Monday, a Wednesday or any other day, a week ends seven days later, regardless of how many hours the individual participated in the course of those seven days. If an individual participates for more than four consecutive weeks or a total of six weeks in a fiscal year, the State may not count those hours toward the participation rate.

Community service programs mean structured programs in which TANF recipients perform work for the direct benefit of the community under the auspices of public or nonprofit organizations. We limit community service programs to projects that serve a useful community purpose. This includes programs in fields such as health, social service, environmental protection, education, urban and rural redevelopment, welfare, recreation, public facilities, public safety, and child care. Community service programs must be designed to improve the employability of recipients not otherwise able to obtain employment and must be supervised on an ongoing basis no less frequently than daily. A State agency shall take into account, to the extent possible, the prior training, experience, and skills of a recipient in making appropriate community service assignments.

This definition limits the activity to what many commonly think of as ''community service.'' It excludes, for example, activities such as participation in a substance abuse treatment program, mental health and family violence counseling, life skills classes, parenting classes, job readiness instruction, and caring for a disabled household member, which while important and beneficial, are not primarily directed to benefiting the greater community. As we stated in the preamble to the original final TANF rule (64 FR 17778, April 12, 1999), ''The fact that something has value or is integral to a countable activity does not necessarily mean it can count as participation.'' We reaffirm that perspective under this interim final rule.

Community service programs must include structured activities that both provide a community service and also improve the employability of participants. Some existing State community service programs allow and count unstructured activities that are undertaken with little or no supervision. One State, for example, considers shoveling a neighbor's sidewalk or helping a friend with errands to be community service. Another State counts serving as a foster parent as a community service. Although these activities benefit the community, they do not necessarily involve real supervision or help an individual move toward self-sufficiency. Unlike other work activities, Congress added the term ''programs'' after community service, suggesting that allowable activities should involve structure and supervision. Thus, shoveling sidewalks would meet this criterion only if done as part of a neighborhood maintenance program undertaken by a public or nonprofit agency. In such an environment, this activity would not only address unmet community needs, but also would help participants develop basic works skills, improve work habits, and help move participants toward employment.

In addition, community service programs do not include activities that meet the definition of another allowable TANF work activity. Several States, for example, count job search and job readiness activities, and vocational educational training as part of a community service program. Doing so effectively avoids statutory limitations on these allowable TANF work activities, such as the six-week limitation on counting ''job search and job readiness'' activities, the 12-month limitation on vocational educational training, and the 30-percent limit on counting individuals in vocational educational training. Some States also count participation in otherwise unallowable educational activities as community service. Under our definition, States may not define countable community service programs so broadly as to circumvent statutorily-imposed restrictions on other TANF activities.

We recognize that there may be instances in which other activities are embedded within the community service activity. For example, an individual providing clerical support might attend computer training classes as part of the community service if the assigned activity requires it. Short-term training or similar activities may be counted as community service as long as such activities are of limited duration and are a necessary or regular part of the community service. Activities that are not an integral part of community service cannot count. For example, substance abuse treatment may be a prerequisite for participation in work activities, but it does not count under community service because it is not an integral part of the community service activity.

Examples of programs and activities that fit under our definition of community service include, but are not limited to, work performed for a school (e.g., serving as a teacher's aide), Head Start program (e.g., helping as a parent volunteer), church (e.g., preparing meals for the needy), or government/nonprofit agency (e.g., providing clerical support), as well as participation in volunteer organizations such as Americorps, Volunteers in Service to America (VISTA), or private volunteer organizations.

Vocational educational training (not to exceed 12 months with respect to any individual) means organized educational programs that are directly related to the preparation of individuals for employment in current or emerging occupations requiring training other than a baccalaureate or advanced degree. Vocational educational training participants should be supervised no less frequently than daily.

Vocational educational training programs should be limited to activities that give individuals the knowledge and skills to perform a specific occupation. Under AFDC and the Job Opportunities and Basic Skills (JOBS) Training programs, basic and remedial education, education in English proficiency, and postsecondary education were statutorily authorized activities. However, PRWORA did not include these activities as separate work activities. Although they may help prepare individuals for employment, they are generally not considered vocational education or training and Congress purposely concentrated the TANF work activities on those focused on employment.

Some existing State vocational educational training programs allow other educational activities such as basic skills, language training, and postsecondary education leading to a baccalaureate or advanced degree. We are explicitly restricting these practices to prevent the use of the term ''vocational educational training'' from covering virtually any educational activity. In particular, the TANF program was not intended to be a college scholarship program for postsecondary education. Programs authorized by the Higher Education Act of 1965 (and subsequent amendments) support these longer-term educational activities. In contrast, activities such as basic education and language training qualify as education directly related to employment.

Some States count education leading to a high school diploma as vocational educational training. Although vocational education is often provided in high school, minor parents attending high school, even if in a vocational education track, should be counted as

participating in ''satisfactory attendance at secondary school or in a course of study leading to a certificate of general equivalence.'' Doing so avoids triggering the lifetime 12-month limit on the use of vocational educational training.

We recognize that there may be instances in which basic skills education is embedded within a vocational educational training activity. Such basic skills education may be counted as vocational educational training as long as it is of limited duration and is a necessary or regular part of the vocational educational training. Basic skills education of this nature may enhance preparation for the labor market by giving participants an opportunity to apply their learning in the context of their future jobs.

Our definition of vocational educational training narrows the scope of what counts for this activity to programs that prepare participants for a specific trade, occupation, or ''vocation.'' This definition is consistent with definitions used in other Federal programs that provide vocational education, such as the Carl D. Perkins Vocational and Applied Technology Education Act of 1990. Even so, this definition could overlap with other TANF work activities that provide training, including on-the-job training and job skills training. Since we want to define work activities that are mutually exclusive, we are interested in comments on how States currently implement this component and whether the definition should be broadened.

Vocational educational training must be provided by education or training organizations, which may include, but are not limited to, vocational-technical schools, community colleges, postsecondary institutions, proprietary schools, non-profit organizations, and secondary schools that offer vocational education.

Under vocational educational training, States may not count unsupervised homework time as part of the hours of participation. We do, however, permit hours to count where a State structures a vocational educational training program to include monitored study sessions and it can document the hours of participation.

Job skills training directly related to employment means training and education for job skills required by an employer to provide an individual with the ability to obtain employment or to advance or adapt to the changing demands of the workplace. Job skills training can include customized training to meet the needs of a specific employer or it can be general training that prepares an individual for employment. This can include literacy instruction or language instruction when such instruction is explicitly focused on skills needed for employment or combined in a unified whole with job training. Job skills training directly related to employment should be supervised on an ongoing basis no less frequently than daily.

Some States include barrier removal activities as job skills training, such as substance abuse counseling and treatment, mental health services, and other rehabilitative activities. While we encourage States to work with individuals in these areas, the definition of job skills training focuses on educational or technical training that is designed specifically to help individuals move into employment.

Education directly related to employment, in the case of a recipient who has not received a high school diploma or a certificate of high school equivalency means education related to a specific occupation, job, or job offer. This includes courses designed to provide the knowledge and skills for specific occupations or work settings, but may also include adult basic education and ESL. Where required as a prerequisite for employment by employers or occupations, this activity may also include education leading to a General Educational Development (GED) or high school equivalency diploma. Participants in education directly related to employment should be supervised on an ongoing basis no less frequently than daily.

Participants should make ''good or satisfactory progress'' in order for their hours to count. This includes a standard of progress developed by the educational institution or program in which the recipient is enrolled. Good or satisfactory progress should be judged by both a qualitative measure of progress, such as grade point average, as well as a quantitative measure, such as a time frame within which a participant is expected to complete such education. We are interested in receiving comments that describe other possible criteria or definitions for what constitutes making ''good or satisfactory progress.''

As under other TANF educational activities, States may not count unsupervised homework time as part of the hours of participation for this activity. We do permit hours to count where a State structures a program of education directly related to employment to include monitored study sessions and it can document the hours of participation.

Satisfactory attendance at secondary school or in a course of study leading to a certificate of general equivalence, in the case of a recipient who has not completed secondary school or received such a certificate means regular attendance, in accordance with the requirements of the secondary school or course of study at a secondary school, or in a course of study leading to a certificate of general equivalence, in the case of a recipient who has not completed secondary school or received such a certificate. The former is aimed primarily at minor parents still in high school, whereas the latter could apply to recipients of any age. Unlike ''education directly related to employment,'' this activity need not be restricted to those for whom obtaining a GED is a prerequisite for employment. However, this activity may not include other related educational activities, such as adult basic education or language instruction unless it is linked to attending a secondary school or leading to a GED. Participants in this activity should be supervised on an ongoing basis no less frequently than daily.

In addition to regular school attendance at a secondary school or in a course of study leading to a certificate of general equivalence, participants should be making ''good or satisfactory progress'' for the activity to count. This includes a standard of progress developed either by the State or by the educational institution or program in which the recipient is enrolled. In addition, it must include both a qualitative measure of progress, such as grade point average, as well as a quantitative measure, such as a time frame within which a participant is expected to complete such education. We are interested in receiving comments that describe possible criteria or definitions for what constitutes making ''good or satisfactory progress.''

As under other TANF educational activities, States may not count unsupervised homework time as part of the hours of participation for this activity. We do permit hours to count where a secondary school or structured GED program includes monitored study sessions and it can document the hours of participation.

Providing child care services to an individual who is participating in a community service program means providing child care to enable another TANF recipient to participate in a community service program. Participants in this activity should be supervised on an ongoing basis no less frequently than daily.

It does not include providing child care to enable a TANF recipient to participate in any of the other eleven allowable work activities. Child care

provided to TANF recipients (and others) in other activities typically involves payment for services rendered and would be classified as unsubsidized employment. Indeed, providing child care for TANF recipients in community service could also be considered under other TANF work activities, such as unsubsidized employment, work experience, or community service. We are interested in comments that describe how this activity differs and might be distinguished from other work activities.

We caution States to implement this activity responsibly. Because assistance is time-limited, States should ensure that the activity is effective in helping move the provider toward self-sufficiency. Training, certification or mentoring will help make the activity meaningful and could be a first step toward the provider's employment in the child care field.

The Deficit Reduction Act of 2005 also requires us to include families receiving assistance under a separate State program that is funded with money counted towards the State's MOE requirement and to specify the circumstances under which a parent who resides with a child who is a recipient of assistance should be included in the work participation rates. The simplest way for us to do this was to use a new term, ''work-eligible individual'' to describe anyone whose participation in work activities contributes to determining whether the family counts in the calculation of the work participation rate. We drew the term from the heading to the statutory section with this new requirement.

Thus we define a *work-eligible individual* as one of two types of adults. The first is an adult (or minor child head-of-household) *receiving assistance* under TANF or a separate State program, unless excluded. The second is a *non-recipient parent* living with a child receiving assistance, unless the parent is a member of one of three excluded groups of parents described below.

In drafting this provision of the regulations, we considered in turn each type of family in which a parent resides with a child recipient of assistance to determine whether it was appropriate to include that group of families in the calculation of the work participation rates. We chose to exclude the following non-recipient parents living with a child receiving assistance from the definition of work-eligible individual: a minor parent who is not a head-of-household (or a spouse of head-of-household); an alien who is ineligible to receive assistance due to his or her immigration status; and, at State option on a case-by-case basis, a recipient of Supplemental Security Income (SSI) benefits. We have excluded these groups because they either cannot receive TANF-funded services or it would be inappropriate to require them to work. For example, many immigrant families lack a work authorization or permit and requiring these adults to work would be a violation of their immigration status. In the case of non-recipient minor parents, we want to encourage them to stay in school and complete their education.

Unless otherwise excluded above, we chose to include all other non-recipient parents living with a child receiving assistance as work-eligible individuals. This new language primarily adds child-only cases to the work participation rates, but could include some two-parent cases where both parents live in the household but one is not part of the assistance unit. In particular, it adds families in which non-recipient parents were removed from a case due to a sanction or a State time limit. We have included these groups because expecting parents to participate in work activities is consistent with the goal of reducing dependency by promoting work. Further, such a policy improves the consistency of the work participation rate calculation across States, specifically called for in the Deficit Reduction Act of 2005.

To illustrate the importance of including these families, consider the situation of a parent whose needs have been removed from the case due to a work-related penalty. The effect on a family's grant of removing a parent's needs from the assistance unit is often no different from the effect of a sanction that uses a fixed percentage or dollar amount. Yet, under the original TANF rules, cases with a parent's needs removed were excluded from the calculation of work participation rates because they became child-only cases, whereas those subject to fixed percentage or dollar amount sanction methods were, by law, excluded for a maximum of only three months in a 12-month period. Under the interim final rule, we bring consistency to how we treat all sanction methods in the participation rates. Similarly, families in which non-recipient parents whose needs have been removed from the case for other types of sanctions will now be included in the calculation of work participation rates.

We give States the option of including on a case-by-case basis families in which a non-recipient parent receives SSI. SSI recipients are not eligible for TANF benefits and we recognize that many are unable to work. Therefore it would not be appropriate to require inclusion of their families in the rates. However, the Social Security Administration is working to remove disincentives to work from the SSI program, and we would like to encourage States to support these efforts through their TANF programs. Therefore, we will allow States to receive credit toward the TANF participation rates for any parents that are able to participate in these efforts by including their families in both the numerator and the denominator of the calculation of the participation rate on a case-by-case basis.

We also chose to exclude from the definition of a work-eligible individual a parent providing care for a disabled family member living in the home who does not attend school on a full-time basis. The State must provide medical documentation to support the need for the parent to remain in the home to care for the disabled family member. We recognize that parents responsible for disabled family members often encounter problems finding affordable and appropriate care and may not be able to participate in TANF work activities to the same extent as other adults. We therefore exclude them from the participation rate calculation. We chose not to count their participation as one of TANF's work activities, as several States did under prior rules, because this activity cannot be easily supervised and is not focused on preparing individuals for unsubsidized employment.

In drafting this interim final rule, it has been our goal to ensure that States can meet the needs of all individuals in their caseloads. We are interested in receiving comments about our approach in this area, particularly with respect to a State's ability to serve families struggling to escape welfare dependency in which there is an individual with a disability.

Finally, readers should note that the definition of ''work-eligible individual'' does not include individuals in families served under an approved Tribal TANF program, even if those families receive State MOE funding, unless the State includes those Tribal families in calculating work participation rates, as permitted under § 261.25.

Subpart A—What Are the Provisions Addressing Individual Responsibility?

We made no changes to this subpart.

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?

At the heart of PRWORA was the expectation that we hold States accountable for moving families from welfare to self-sufficiency through work. Each State had to meet two separate work participation rates that reflected how well it succeeded in engaging adults in work activities. The minimum participation rate for adults in all families (the overall rate) started at 25 percent in FY 1997 and rose to 50 percent in FY 2002 and thereafter. The minimum participation rate for adults in two-parent families (the two-parent rate) was 75 percent in fiscal years 1997 and 1998, increasing to 90 percent afterward. A State that failed to meet the required participation rates was subject to a monetary penalty. The Deficit Reduction Act of 2005 retains the 50 percent participation requirement for all families and the 90 percent requirement for two-parent families, but includes families in separate State programs in the calculation of the respective work participation rates.

Our original TANF rule included similar but separate regulatory provisions for the ''overall'' and ''two-parent'' participation rates. These same distinctions and provisions are continued in this interim final rule, but we extend the calculation of work participation rates to include families with a work-eligible individual in order to conform to our new wording on calculating the work participation rates. We also added a reference to the years that the participation rates apply.

Section 261.21 What overall work rate must a State meet?

Under PRWORA, the overall participation rate for adults in families started at 25 percent in FY 1997 and increased by five percentage points each year to 50 percent in FY 2002 and thereafter. Under our prior TANF rules, this section of the regulation included a chart of the minimum participation rates required by fiscal year. The Deficit Reduction Act of 2005 continues the overall work participation rate at 50 percent in FY 2006 and thereafter. Under the interim final rule, we have deleted the former phased-in participation rate chart and updated the language to reflect these statutory requirements.

Section 261.22 How will we determine a State's overall work rate?

To determine a State's participation rate, PRWORA called for dividing the number of families receiving TANF assistance that include an adult or a minor child head-of-household engaged in work activities by the total number of such families, excluding families sanctioned that month for refusal to participate in work activities, as long as they had not been penalized for more than three months in the preceding 12-month period. A State could also exclude from the denominator single-parent families with a child under the age of one for not more than a total of 12 months or include or exclude families receiving assistance under a tribal family assistance plan or under a tribal Native Employment Works (NEW) program.

The Deficit Reduction Act of 2005 modifies the work participation rate calculation to include families with an adult or minor child head-of-household under State programs funded with qualified State expenditures and other work-eligible individuals, which we have defined in § 261.2. In §§ 261.22(a)(2) and (b)(1), we simply modify the prior language to reflect this new calculation.

In general terms, the original participation rate calculation excluded two categories of families. First, it excluded families subject to a work sanction for not more than three months in the preceding twelve months. Second, it excluded (for a maximum of 12 months) families in which a single custodial parent is caring for a child less than one year old. In this interim final rule, we clarify that States may apply both of these exclusions on a case-by-case basis for families with a work-eligible individual §§ 261.22(b)(3) and (c)(2).

As we note in the preamble to § 261.24, we do not consider a two-parent family with a disabled work-eligible individual to be a two-parent family for work participation rate purposes. The statute directs us to exclude these families from the two-parent work participation rate calculation, but not from the overall work participation rate calculation.

Similar to the policy we allowed under the original TANF rule, States may now count families for a partial month if a work-eligible individual is engaged in work for the minimum average number of hours in each full week that the family receives assistance.

This policy is now added to the rule at § 261.22(d)(1). States that pay benefits retroactively also have the option to consider the family to be receiving assistance during the period of retroactivity under § 261.22(d)(2).

Section 261.23 What two-parent work rate must a State meet?

Under PRWORA, the overall participation rate for two-parent families started at 75 percent in FY 1997 and increased to 90 percent in FY 1999 and thereafter. Under prior TANF rules, this section of the regulation included a chart of the minimum participation rates required by fiscal year. The Deficit Reduction Act of 2005 continues the two-parent work participation rate at 90 percent in FY 2006 and thereafter. Under the interim final rule, we have deleted the former phased in participation rate chart and updated the language to reflect these ongoing statutory requirements and dates.

Section 261.24 How will we determine a State's two-parent work rate?

The Deficit Reduction Act of 2005 modifies the statute to include in the two-parent work participation rate calculation two-parent families in ''State programs funded with qualified State expenditures.'' It also gave us the authority to include other two-parent families with work-eligible individuals, which we have defined in § 261.2. In §§ 261.24(a)(2), (b)(1) and (b)(2) we modify the language to reflect the new statutory participation rate calculation.

The original two-parent participation rate calculation also excluded families subject to a work sanction for not more than 3 months in the preceding 12 months. We modify this exclusion at § 261.24(b)(2) to apply to two-parent families with work-eligible individuals.

Additionally, under § 261.24(d) we clarify two provisions of current policy: (1) We count toward the participation rate those families receiving assistance for a partial month if a work-eligible individual is engaged in work for the minimum average number of hours in each full week that the family receives assistance; and (2) States that pay benefits retroactively also have the option to consider the family to be receiving assistance during the period of retroactivity.

Unchanged by the Deficit Reduction Act of 2005, we will continue to sum the participation hours of both parents in the assistance unit when calculating the two-parent rate. This differs from the way two-parent families are treated in the overall work rate, which requires that all of the participation requirements be met by one of the adults in the assistance unit. Also, as under PRWORA and the original rule in paragraph (e) of this section, we do not

consider a two-parent family with a disabled work-eligible individual to be a two-parent family for work participation rate purposes.

Section 261.25 Do we count Tribal families in calculating the work participation rate?

This section of the prior rule permits a State to include families that are receiving assistance under an approved Tribal family assistance plan or under a Tribal work program in calculating the State's participation rate. We have made a slight change to this section in the interim final rule by adding the term ''with a work-eligible individual'' after family to be consistent with our revised calculation methods and the definition of a work-eligible individual in § 261.2.

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

We revised only two sections of subpart C.

Section 261.31 How many hours must a work-eligible individual participate for the family to count in the numerator of the overall rate?

As we explained in § 261.2, we added a new definition of a work-eligible individual for purposes of calculating the work participation rates. The only changes we have made to § 261.31 are to incorporate this phrase into the heading and to substitute the phrase ''work-eligible individual'' for the word ''individual'' where it is appropriate.

We would like to emphasize that under these rules States retain the flexibility to assign an individual to a combination of activities, for example blending school and work or training and work or job search and community service, to reach the hours needed to count a family in the rate. We encourage States to use this approach where it best serves the needs of their clients.

A work-eligible individual who participates in a work experience or community service program that is subject to FLSA requirements cannot be required to participate in that work activity for more hours than the welfare grant divided by the minimum wage. For some families, the TANF grant divided by the minimum wage does not result in enough hours to satisfy TANF's minimum hourly requirements. In general, a TANF grant of less than $446 would result in fewer than 20 hours of countable participation per week through an activity that is subject to the FLSA requirements. (This amount is based on the Federal minimum wage; it would be smaller in States that have a higher State minimum wage.) For a family of three, the maximum TANF grant in about 30 States is less than $446 per month; however, the FLSA calculation is not limited to the TANF grant.

According to the Department of Labor's guidance entitled ''How Workplace Laws Apply to Welfare Recipients'' (May 1997), a State may count the cash value of food stamps toward participation requirements if the State adopts a food stamp workfare program. In addition, a State could adopt a Simplified Food Stamp Program, which would allow it to match its food stamp exemptions to those of its TANF program. For example, the Food Stamp Program exempts single parents with a child under age 6 from participation. Adopting a Simplified Food Stamp Program would allow a State to count food stamp benefits toward the hours of required participation for this otherwise exempt group. By adding the value of food stamps, recipients in most States could meet current TANF's requirement for 20-hour per week of core activities. Indeed, the combined TANF/Food Stamp benefit in all States for a family of three or more exceeds the $446 threshold.

Even after counting the value of food stamps, in some States TANF families with just one or two people in the assistance unit may still not have a large enough combined TANF/food stamp grant to generate the 20 hours per week of participation needed to satisfy TANF's core activity requirement. The combined benefits also may not be enough for families that have unearned income, such as Social Security and child support, and do not receive the maximum TANF grant. Moreover, some TANF families do not receive food stamps, so there is no food stamp benefit to add to the calculation.

Under this interim final rule, we allow States to count any family that participates the maximum hours it is allowed under the minimum wage requirement of the FLSA as having satisfied the 20-hour per week core activity requirement if actual participation falls short of 20 hours per week. We are limiting this policy to States that have adopted a food stamp workfare program and a Simplified Food Stamp Program to ensure that recipients participate to the fullest extent possible and that the calculation of the work participation rate is based on uniform standards across all States. The Simplified Food Stamp Program must be structured to match food stamp exemptions to those of the TANF program so that work requirements could be applied to as many work-eligible individuals as possible. Families that need additional hours beyond the core activity requirement must satisfy them in some other TANF work activity.

This policy respects the protections that the FLSA affords to individuals in positions subject to the minimum wage requirement. At the same time, it gives added flexibility in the work participation rate for States that maximize the hours they can require of individuals in such positions.

We considered remaining silent on FLSA; however, given the challenge of meeting the work participation rates under the Deficit Reduction Act of 2005, we thought it important to address this issue in a consistent and fair manner. Nearly all States have some cases that cannot meet the 20-hour minimum required in core work activities to count toward the work participation rate. The FLSA clarification provides States with increased flexibility to assign work activities and meet work participation rates while treating participants subject to the FLSA requirements fairly. We also considered establishing a maximum number of hours that a State could use to meet the core hour requirement, such as 5 hours per week. While this would be an improvement over existing rules, a 5-hour cap would only address a portion of the affected cases and would be administratively complex; therefore we decided against this approach.

Section 261.32 How many hours must a work-eligible individual participate for the family to count in the numerator of the two-parent rate?

In similar fashion to § 261.31 above, we substituted the phrase ''work-eligible individual'' for the word ''individual'' in the heading and in the section as needed to clarify how States can count hours and the calculation of the two-parent work participation rate. Again, we stress that States may combine the activities to which it assigns individuals, blending, for example, school and work or training and work or job search and community service, to reach the hours needed to count a family in the work participation rate.

As we do for single-parent families, when two-parent families have work-eligible individuals in work activities subject to the minimum wage requirement of the FLSA, we will count any family that participates the maximum hours allowable as having satisfied the 30-hour per week (or 50-hour per week, if the family receives federally-funded child care) core activity requirement, even if actual participation falls short of 30 (or 50) hours per week. For a more detailed

discussion of this policy, please refer to the preamble to § 261.31.

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

Under PRWORA, the caseload reduction credit reduces the required work participation rate that a State must meet for a fiscal year by the percentage that a State reduces its overall caseload in the prior fiscal 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. The Deficit Reduction Act of 2005 recalibrates the caseload reduction year by establishing a new FY 2005 base year, which is reflected in this interim final rule in §§ 261.40, 261.41 and 261.42.

Because of the sharp caseload decline since FY 1995, the caseload reduction credit had virtually eliminated participation requirements for most States. By recalibrating the base year for the caseload reduction credit, this provision encourages States to help families become independent.

Section 261.40 Is there a way for a State to reduce the work participation rates?

In this section, we have eliminated the obsolete reference to FY 1995 and replaced it with the new base year of FY 2005, as required by the Deficit Reduction Act of 2005. The caseload reduction credit for a fiscal year equals the percentage point decline in the caseload, net of eligibility changes, between FY 2005 and the prior-year caseload. To simplify the language at § 261.40(a)(3), we have also created a new term—''comparison year''—to refer to the fiscal year that precedes the fiscal year to which the credit applies.

For the two-parent participation rate, our interim final rule continues to allow a State to use the caseload decline, net of eligibility changes, of either the two-parent caseload or the overall caseload.

As under current policy, § 261.40(b)(1) of the interim final rule clarifies that the calculation of the caseload reduction credit must disregard caseload reductions due either to changes in Federal law or to changes that a State has made in its eligibility criteria in comparison to the criteria in effect in the new base year of FY 2005. However at § 261.40(b)(2) we clarify that a State may reduce or offset the disregard for caseload reductions due to changes in eligibility criteria that increase caseloads. In other words, the revised regulatory language simply clarifies our continuing policy: We will calculate a net impact of eligibility changes (i.e., caseload decreases minus increases) if the State provides information on changes that increase the caseload. A State is under no obligation to provide the impacts of changes that increase the caseload. Such impacts merely serve to offset the effects of eligibility changes that decrease the caseload and as such are to a State's advantage because they may make for a larger credit.

We will continue to base the caseload decline on the combined TANF and Separate State Program caseload figures for families receiving assistance. As indicated at § 261.40(c), we will use the ACF–199, TANF Data Report, and the ACF–209, SSP–MOE Data Report, to establish both the FY 2005 base-year and the comparison-year caseloads. We have deleted references to earlier data reports needed for the FY 1995 base year. This rule continues to allow States to correct erroneous data and make adjustments to include unduplicated data.

Section 261.41 How will we determine the caseload reduction credit?

Again in this section, we have substituted FY 2005 for any prior reference to FY 1995, as required by the Deficit Reduction Act of 2005. Our interim final rule maintains the same general caseload reduction methodology, while simplifying some of the reporting requirements.

In particular, we have eliminated the requirement formerly located at § 261.41(a)(1), (b)(5) and (b)(6) that States report caseload closure and application denial information because we have found that this information is not always relevant or helpful in estimating the impact of an eligibility change. Instead, a State should submit whatever data or analyses are most relevant for estimating the average monthly impact of individual policy changes on the comparison-year caseload and include that information as an attachment to its ACF 202—TANF Caseload Reduction Report. Those materials should clearly show the step-by-step processes the State uses to arrive at each impact and should demonstrate how the State took into account the effect of the change over time. In conjunction with this interim final rule, we are revising the Caseload Reduction Report form to accommodate the revisions to the credit calculations and to reduce the reporting burden on States.

The interim final rule continues to require under § 261.41(b)(6) that a State certify that it has provided the public an opportunity to comment on the estimates and methodology and incorporated all net reductions resulting from Federal and State eligibility changes. We have, however, dropped the prior requirement that States submit a summary of public comments received about the proposed methodology, as we have not found this helpful to the process of calculating the credits.

The interim final rule also clarifies at § 261.41(c)(2) the language permitting a State requesting a caseload reduction credit for its two-parent caseload to base its estimate on either the change in its two-parent caseload or on the decline in its overall caseload. We made no changes to paragraphs (d), (e) or (f) of the prior rule.

Section 261.42 Which reductions count in determining the caseload reduction credit?

We revised language in § 261.42(a) to clarify that the caseload reduction credit calculation must disregard caseload reductions due either to Federal law or to changes in State eligibility criteria in comparison to the criteria in effect in FY 2005; however, a State may also reduce the disregard for caseload reductions due to changes in eligibility criteria that increase caseloads. As we explained in the preamble to § 261.40, this change only clarifies our ongoing policy of calculating the net impact of eligibility changes (i.e., caseload decreases minus increases) where a State provides information on the impacts of policies that expanded eligibility. In addition, we also incorporated into the regulation at § 261.42(a)(3) our existing policy that a State may not receive a caseload reduction credit that exceeds the actual caseload decline between FY 2005 and the comparison year.

At § 261.42(b), we also clarified in the regulatory language that a State include Separate State Program cases in both its base-year and its comparison year caseloads. We have eliminated the reference to ''cases made ineligible for Federal benefits by Pub. L. 104–93.'' It is no longer relevant due to the change in the base year to FY 2005, required by the Deficit Reduction Act of 2005. Indeed, the new base year also means many caseload reductions due to State changes in eligibility criteria no longer apply because such policies were in effect in the new, recalibrated base year of FY 2005.

Section 261.43 What is the definition of a ''case receiving assistance'' in calculating the caseload reduction credit?

Our interim final rule does not make any changes to the definition of a ''case receiving assistance'' in calculating the

caseload reduction credit. The only change we have made in this section is the elimination of the reference to a State's implementation date formerly in § 261.43(b) which is no longer applicable, with the statutory change in the base year to FY 2005.

Section 261.44 When must a State report the required data on the caseload reduction credit?

Our interim final rule continues to require that a State report the necessary documentation on caseload reductions for the preceding fiscal year by December 31. We have removed the reference to our intent to notify a State of its caseload reduction credit no later than March 31. Discussions with States about their caseload reduction methodology, negotiations about necessary changes, and requesting and receiving additional data and documentation have often gone beyond the prior notification date of March 31. This in no way represents a change in our intention to issue caseload reduction credits as early in a fiscal year as possible.

Subpart F—How Do We Ensure the Accuracy of Work Participation Information?

Under our prior rules, subpart F was entitled ''How Do Welfare Reform Waivers Affect State Penalties?'' Because this subpart now only applies to one State, we moved the subpart to subpart H, with appropriate re-designation and renumbering changes. We also think the new work verification provisions of the Deficit Reduction Act of 2005 more logically follow the discussion of participation requirements and the caseload reduction credit, so we have added them under a new subpart F.

Under the Deficit Reduction Act of 2005, HHS is required to promulgate regulations to ensure consistent measurement of work participation rates. The statute directs the Secretary to include information with respect to (1) determining whether the activities of a recipient of assistance may be treated as a work activity; (2) establishing uniform methods for reporting hours of work of a recipient of assistance; (3) identifying the types of documentation needed by the State to verify reported hours of work; and (4) specifying the circumstances under which a parent who resides with a child who is a recipient of assistance should be included in the work participation rates.

A reliable and consistent work participation measurement system requires uniformity among States in identifying work-eligible individuals and in the counting of work hours. To help achieve this goal, we defined a work-eligible individual and each of the work activities in § 261.2 and created new sections describing methods for reporting and the types of documentation needed to verify a work-eligible individual's hours of participation. To verify work participation information under these rules, each State must establish and maintain the procedures and internal controls outlined below. The following provides the specific new verification requirements we added and the statutory authority for these requirements.

Section 261.60 What methods may a State use to report a work-eligible individual's hours of participation?

Under the prior TANF rule, some States asked whether they were required to report actual hours of participation or whether they could report required or scheduled hours. We replied that ''The State must report the actual hours of participation for each work activity. Reporting required (or scheduled) hours of participation is inconsistent with the 'complete and accurate' standard and is not acceptable.'' (See the answer to question #42 under TANF Reporting Questions under TANF Program Policy Questions and Answers, which can be found on our Web site at: *http://www.acf.dhhs.gov/programs/ofa/polquest/sectone.htm.*)

Our interim final rule at § 261.60(a) makes the existing policy of counting only actual and not scheduled hours explicit in the regulations. The new legislative language in the Deficit Reduction Act of 2005 makes clear that Congress intended that only actual hours of work activities should count toward the participation rates. Allowing scheduled hours would both introduce inconsistencies among States and reduce the incentive for States to ensure that recipients actually participate for the hours they are assigned. Thus, each State must have in place a system for determining whether the hours they report toward the participation rates correspond to hours in which work-eligible individuals actually participate in work activities. The State must describe this system as part of its Work Verification Plan, which we explain in detail at § 261.62.

Under § 261.60(b) of these interim final rules, we continue to permit States to follow ordinary practice for counting work time by basing it on the hours for which the individual was paid, thus allowing for occasional absences due to paid holidays and sick leave. We recognize that all clients, regardless of the activity in which they participate, may miss work or training because of a holiday or a temporary illness.

Thus, our interim final rule permits States to count limited excused absences for individuals in unpaid allowable work activities. A State may define and count reasonable short-term, excused absences for hours missed due to holidays and a maximum of 10 additional days of excused absences in any 12-month period, no more than two of which may occur in a month. In order to count an excused absence as actual hours of participation, the individual must have been scheduled to participate in an allowable work activity for the period of the absence that the State reports as participation.

We believe the 10-day limitation for additional days beyond holidays is an appropriate accommodation that takes into consideration varying work-site and educational practices as well as unexpected events that cause a work-site to close or an individual to miss scheduled hours. Each State must describe its ''excused absence'' policies and practice as part of its Work Verification Plan described below in § 261.62. We considered not addressing excused absences for unpaid participants but rejected this alternative in order to treat recipients in all activities equitably. We also considered permitting more days of excused absences but decided on 10 based on a typical accrued leave scenario for working families. For example, many places of employment allow employees to accrue one half day of leave per two-week pay period, which accounts for about 13 days over a calendar year. These individuals often work 40 hours per week. Our decision to allow 10 days is based on required hours of 20 or 30 hours per week in non-paid work.

We want to emphasize that this ''excused absence'' policy applies to what may be counted in the Federal participation rate. The policy in no way limits a State's flexibility to excuse absences or otherwise make accommodations in the participation requirements it imposes on individuals. That is why the participation requirement is only 50 percent. An individual's requirements are set by the State balancing the goals of the program, the needs of the family, and obligations under the Americans with Disabilities Act (ADA) and Section 504 of the Rehabilitation Act of 1973. Thus, the State may require more or fewer hours of the individual than needed to count the family toward the Federal participation rate. States may also have a more expansive or a more restrictive list of allowable activities than those

that count to meet the Federal participation rate.

Under § 261.60(c) of the interim final rule, we make clear that, in the case of self-employment, as we noted in our discussion of the definition of unsubsidized employment in § 261.2, we will not permit a State to count more hours toward the participation rate for a self-employed individual than the number derived by dividing the individual's self-employment income (gross income less business expenses) by the Federal minimum wage. A State may propose an alternative method of determining self-employment hours as part of its Work Verification Plan.

Finally as a reminder of current policy, because some weeks fall across more than one month, we allow States to choose one of three methods to calculate the average hours per week for such a month. A State may decide that the week falls in the month that includes the majority of the days of that week; it may include the week in the month in which the Friday falls; or it may count each month of the fiscal year as having 4.33 weeks. We considered establishing a single method to promote consistent work participation measurement but ultimately decided against regulating in this area. Any differences in State approaches average out over the fiscal year and thus do not result in inconsistent measurement. In our view, the appeal of a single method does not justify the administrative burden on States that would need to change their data reporting systems.

Section 261.61 How must a State document a work-eligible individual's hours of participation?

To clarify recordkeeping requirements with respect to participation, the interim final rule at § 261.61(a) adds an explicit requirement that a State must verify through documentation in the case file all hours of participation that it reports. The Work Verification Plan required at § 261.62 must describe the forms of documentation that the State will use. Under this requirement, a State may not report data to us on the basis of ''exception reporting'' where States assume that clients participate in all scheduled hours unless it receives a report to the contrary from a service provider.

As explained at § 261.61(b), we expect that many States will continue to use pay stubs as the basis for documenting hours of participation in unsubsidized employment, provided by either the employee or employer at State-specified periods. This approach has significant advantages: It uses an existing system of valid documents for which the employer has great incentives to ensure accuracy, and it minimizes reporting burden. Other possibilities include timecards, sign-in/sign-out sheets, and rosters with recorded hours of work.

We encourage States to develop systems that minimize requests for documentation from an employer of an employee's hours of participation. We want to ensure that our documentation and verification requirements do not discourage work by placing an undue burden on the employer because a primary goal of TANF is to help clients achieve self-sufficiency through unsubsidized work.

Under § 261.61(c) of the interim final rule, we permit States to report projected actual hours of unsubsidized or subsidized employment or OJT for up to six months at a time on the basis of prior, documented actual hours of work. This rule is similar to the ''prospective budgeting'' that was used to calculate earned income and grant amounts under the former AFDC program. If a State chooses to project actual hours of work, the State must provide its policies and practices in its Work Verification Plan required under § 261.62(b).

An example will illustrate what we envision. Based on valid documentation such as pay stubs, or employer reports, a State knows that a client averages 32 hours of work per week. As long as the State receives no conflicting information, the State may report 32 hours of participation a week in employment for a maximum of the next six months. At the end of this six-month period, the State must obtain new valid documentation or re-verify the client's current, actual average hours and these hours may be reported for another six-month period. If, at any time, the State becomes aware of a change in the client's work situation, the new actual hours must be documented and may be prospectively reported for six months. For example, if a client requests a grant adjustment due to either increased or decreased wages, this report would require documentation and a restatement of the actual hours of participation.

In developing this option, we considered whether the timeframe should be shorter, for example three months. However, we believe that a six-month period appropriately balances the administrative burden with the Deficit Reduction Act's new emphasis on verification and documentation. We want to emphasize that this method of reporting projected actual hours is only permitted for paid employment under the activities of unsubsidized employment, subsidized employment or OJT.

For non-employment activities, as outlined in § 261.61(d), we believe States should require service providers to document the hours of their clients' participation. Documentation could include time sheets, service provider attendance records and school attendance records. If there are other documents that would substantiate the hours an individual participates in these activities, the State should specify them in its plan. Contractual arrangement with service providers of work activities should require documentation of the hours in which an assigned recipient participates.

Section 261.61(e) relates to reporting self-employment hours. In such cases, there is neither an employer to issue a pay stub nor a supervisor or teacher to monitor participation. Therefore, the State needs another approach to documenting the hours it reports for the participation rate. Under these circumstances, we will allow States to count the number of hours derived by dividing the individual's self-employment income (gross income less business expenses) by the Federal minimum wage. A State may propose an alternative method of determining self-employment hours as part of its Work Verification Plan. We will not approve plans that provide for an individual's self-reporting of participation without additional verification.

Section 261.62 What must a State do to verify the accuracy of its work participation information?

The Deficit Reduction Act of 2005 requires the Secretary to issue rules on determining whether activities may be counted as work activities, verifying countable hours of work, and determining who is a work-eligible individual. Under § 261.62(a), a State must establish and employ procedures for: (1) Determining whether its work activities may count for participation rate purposes; (2) determining how to count and verify reported hours of work; (3) identifying who is a work-eligible individual; and (4) internal controls to ensure compliance with the procedures; and (5) submit a complete Work Verification Plan to the Secretary for approval. We outline our expectations and guidelines for these requirements below.

Procedures for determining whether work activities may count for participation: Under § 261.62(b)(1)(i) for each of its work activities, a State must establish procedures to ensure that the activity is consistent with one of the work definitions in § 261.2. Hours of participation must be reported for the proper countable work activity. For

example, our definition of a community service program excludes activities that do not directly benefit the community. Therefore, family- and self-improvement activities can no longer be counted as a community service work activity in the participation rate. For each work activity, the State's procedures should specify the types of situations and range of activities which will be included.

Procedures for determining how to count and verify reported hours of work: Under § 261.62(b)(1)(ii), for each countable work activity in which a work-eligible individual participates, States must report the actual hours of participation in the report month and calculate and report the average hours of participation per week for each month in the quarter. Acceptable documentation for the reported hours must be based on affirmative reports that the individual actually participated for the reported hours, rather than an exception reporting system.

Under § 261.62(b)(1)(iii), for each of the work activities, a State must describe in its Work Verification Plan the documentation it uses to monitor participation and ensure that it reports actual hours of participation. While all activities must be supervised no less than daily to count in the work participation rate, we are establishing a range of documentation guidelines that vary by type of activity. Job search and job readiness assistance should be documented daily due to the short-term nature of this activity. Other unpaid work activities, including work experience, community service programs, vocational educational training, and providing child care to participants in community service programs, require documentation of hours of participation no less than every two weeks. For paid employment, as we explain in the preamble to § 261.61(c), States may report projected actual hours for up to six months at a time. Readers should refer to § 261.61 for additional detail about documentation requirements.

Currently, States may report the family and individual-level data that HHS uses to calculate work participation rates on either a sample or population basis. To minimize the documentation verification burden on States that report using a sample, we expect to focus audits and reviews on the sample cases used to calculate participation rates. These sample cases should contain all the documentation needed to count and verify reported hours of work and identify who is a work-eligible individual. It is important for States using population data to ensure that all cases contain all the documentation needed to count and verify reported hours of work and identify who is a work-eligible individual. We would be interested in suggestions or approaches as to how to minimize the documentation burden for the States that report the entire universe of population data.

Procedures for identifying who is a work-eligible individual: [§§ 261.62(b)(2) and (3)] The Deficit Reduction Act of 2005 requires the Secretary to identify the circumstances under which a parent who resides with a child who is a recipient of assistance should be included in the work participation rates. Thus, we have defined a work-eligible individual in § 261.2 and have added a data element ''Work-eligible Individual Indicator'' to the quarterly data reports. This definition includes all adults and minor child heads-of-household receiving assistance and some non-recipient parents.

Identifying adult and minor child head-of-household recipients as work-eligible individuals should not be difficult—they have been included in the work participation rates since the inception of the TANF program. However, we now require that some non-recipient parents be included to ensure consistent work participation rates. For example, a parent whose needs have been removed from the grant due to a work-related sanction is included in the definition of a work-eligible individual and in the work participation rate. (Please refer to the discussion in the preamble to § 261.2 for more detail about the definition of a work-eligible individual.) State procedures must be able to identify all individuals in TANF and separate State programs claimed for MOE (SSP–MOE) families who meet the definition of a work-eligible individual.

Internal controls to ensure compliance with the procedures: Each State, under § 261.62(b)(5) must develop internal controls and procedures that are sufficient to verify and validate the work participation rates. Internal controls include the State's mechanism for monitoring the quality of its work participation data and may entail such approaches as a secondary-stage supervisory review, special studies, regularly scheduled audits or ongoing sampling and quality assurance processes that are used to monitor adherence to established policies and work verification procedures by staff and contractors.

Work Verification Plan: Paragraph (b) of § 261.62 describes what must be included in a State's Work Verification Plan. The plan must include a description of the procedures and documentation requirements outlined above. In addition, under § 261.62(b)(3) a State must include a description of how it: Accurately inputs into its automated data processing system; properly tracks the hours; and accurately reports the hours. Paragraph (b)(4) requires a description of the procedures for ensuring that only hours of participation in an activity that meets a Federal definition are transmitted as countable work activities and paragraph (b)(5) requires a description of the internal controls to ensure a consistent measurement of the work participation rates, including any quality assurance processes and sampling specifications. Under paragraph (c) we state that we will review a State's plan for completeness and approve it if we believe it will result in accurate reporting of work participation information.

States may develop internal control and verification systems that match their unique program resources and operational requirements. Some States rely on client information systems and/or use integrated data warehouses to collect and process work participation information. These States are able to compile electronically all or most of the work participation data items, control for the special rules and conditions that apply to the Federal work activities, compute the average hours across all activities for the month, perform item-by-item edit checks, and control for internal consistency and completeness of the work participation data. Some systems can validate the work data against the National Directory of New Hires database or State Employment Security files. Other States may rely on TANF case managers to accurately track the participation data, including the participation hours and application of the special rules and conditions.

Some current systems may be inadequate to meet the new verification and validation requirements of the statute and this rule. States may need to develop and conduct quality assurance systems and tests. Using these procedures, States could: (1) Perform case reviews to validate the accuracy of the data reported; (2) examine documentation for the reported hours of work; (3) test how the hours of participation were calculated; (4) check how data is tracked through the system; (5) review the verification procedures to ensure they are doing what was intended; and (6) check what procedures State staff, local staffs, and contractors are actually using to document, count and report hours of participation.

The State's Work Verification Plan also should describe the State's procedures for controlling for data errors in inputting work participation items to the TANF report file. These include transcription and coding errors, data omissions, computational errors, and compilation errors. The plan should document the checks used to isolate electronic systems and programming errors and the steps to ensure that all work participation report items are internally consistent. If sampling is used to perform quality assurance tasks to test the validity of the participation information, the State should include the sampling specifications in its verification plan.

Section 261.63 When is the State's Work Verification Plan Due?

In accordance with the Deficit Reduction Act of 2005, paragraph (a) requires that each State submit its interim verification procedures for validating work activities reported in the TANF Data Report and, if applicable, the SSP–MOE Data Report to the Secretary no later than September 30, 2006. In addition, under paragraph (b), a State must submit revisions requested by the Department within 60 days of receipt of our notice, and must submit and operate under an approved Work Verification Plan no later than September 30, 2007.

Paragraph (c) describes the time frame for submitting a revised verification plan to the Secretary for approval. A State must submit its revised Work Verification Plan by the end of the quarter in which the State modifies its procedures or internal controls. Validating work activities is an ongoing process that uses internal controls to check that staff is properly applying the verification procedures, to ensure that computer systems have been accurately programmed to implement the verification procedures, and to ensure the verification procedures are working properly. As problems are identified, a State may need to modify its verification procedures and/or internal controls.

Section 261.64 How will we determine if the State is meeting the requirement to establish and maintain work verification procedures that ensure an accurate measurement of work participation?

The Deficit Reduction Act of 2005 adds a new penalty provision to the Social Security Act at section 409(a)(15) for a State's failure to establish or comply with its work participation verification procedures. We will determine whether to impose this penalty based on two conditions. First, as provided in paragraphs (a) and (b), the State will be liable for a penalty if it fails to establish its work verification procedures by submitting its interim Work Verification Plan by September 30, 2006, or it fails to have its complete plan approved by September 30, 2007. A complete Work Verification Plan includes all the information required by § 261.62(b) and a certification that it accurately reflects State operating procedures.

Second, as set forth in paragraph (c), beginning in FY 2008, we will use the single audit under OMB Circular A–133 in conjunction with other reviews, audits, and data sources to assess the validity of a State's internal control procedures and the accuracy of the data filed by States to calculate the work participation rates. We will determine whether a State is penalty-liable based on the findings drawn from a sample of cases during the single audit or via another Federal review. Therefore, States must maintain case documentation and pertinent findings produced through its verification process for use by the single State audit or ACF in its review of the State's work participation verification system.

Section 261.65 Under what circumstances will we impose a work verification penalty for failure to submit a work verification plan or for failure to maintain adequate internal controls to ensure a consistent measurement of the work participation rates?

The new statutory penalty language at section 409(a)(15)(B) of the Social Security Act requires us to base the penalty on the State's degree of noncompliance with its work verification procedures, and that it equal an amount of not less than one percent and not more than five percent of the State's adjusted SFAG. Under paragraph (a) of this section, we will take action to impose a penalty if the State has not met the requirements of § 261.64. Under paragraph (b), if a State fails to submit its interim Work Verification Plan by the due date of September 30, 2006, or fails to revise its procedures based on Federal guidance and submit the complete plan by September 30, 2007, that we approve, we will impose a penalty of five percent, because the State will not have complied with the fundamental requirements of the law.

Under paragraph (c), if, beginning in FY 2008, we determine, through audits or special reviews, that the State has not maintained adequate documentation, verification and internal control procedures to ensure the accuracy of the data used in calculating the work participation rates over the course of a fiscal year we will base the penalty on the number of times the State fails to meet the requirements. We will impose a penalty based on the number of years that a State fails to comply, i.e., one percent of the adjusted SFAG for the first year, two percent for the second year, three percent for the third year until a maximum of five percent is reached. If a State subsequently complies with its work verification procedures for two consecutive years after any failure, we will consider a subsequent failure to be the first occurrence again.

If a penalty is assessed, we will impose it in the immediately succeeding fiscal year. States that are subject to a penalty for failure to comply with work verification procedures may claim reasonable cause as specified at § 262.5. They may also submit a corrective compliance plan to remedy the deficiency as described at § 262.6. States that elect to enter into a corrective compliance plan will have the same time frame for correcting this violation that applies to the penalty for failing to satisfy the minimum work participation rates and the penalty for failing to comply with the five-year limit on the receipt of Federal assistance under § 262.6(e)(1). Thus, any State that is subject to a penalty for failing to establish or comply with the work participation verification procedures must fully correct the violation by the end of the first fiscal year ending at least six months after our receipt of the State's corrective compliance plan. We may also require an amendment to the State Verification Plan as one of the steps the State must take to correct or discontinue the violation. We have added this requirement to § 262.6(f).

Part 262—Accountability Provisions—General

Section 262.1 What penalties apply to States?

The Deficit Reduction Act of 2005 adds an additional penalty at section 409(a)(15) of the Social Security Act for States that fail to establish or comply with work participation verification procedures. If we determine that this penalty applies, then we must reduce the adjusted SFAG payable for the immediately succeeding fiscal year by not less than one percent and not more than five percent. (See the discussion in the preamble discussion for subpart F of part 261 of this chapter.) States may avail themselves of the penalty resolution process provided in §§ 262.4 through 262.7, which may enable the State to avoid this penalty. We added

this new penalty at (a)(15) and (c)(2) of this section.

Section 262.2 When do the TANF penalty provisions apply?

The penalty for States that fail to establish work participation verification procedures takes effect on October 1, 2006. If a State does not comply with these new work participation verification procedures by October 1, 2007, it will be subject to the penalty. We have added this provision as paragraph (d) of this section. Postponing penalty action until the beginning of FY 2008 for compliance will provide States with sufficient time to implement fully the changes associated with the development of work verification procedures.

Section 262.3 How will we determine if a State is subject to a penalty?

In the preamble to §§ 261.64 and 261.65, we noted that we will impose the penalty for failure to establish or comply with work participation verification procedures based on two conditions. The first condition will depend on whether or not the State has submitted acceptable work participation verification procedures to us. The second condition will depend on the findings drawn from a sample of cases during the single audit or via another federal review. We will use the single audit under OMB Circular A–133 as well as other avenues (e.g., other reviews, audits, and data sources) as appropriate to determine whether the penalty applies. We have added these procedures to paragraph (a)(1) of this section.

Section 262.6 What happens if a State does not demonstrate reasonable cause?

States that are subject to a penalty for failure to establish or comply with work participation verification procedures will have the opportunity to claim reasonable cause as specified at § 262.5 and/or submit a corrective compliance plan to remedy the deficiency as described in this section.

In order for a State to avoid a penalty, the State must fully correct or discontinue the violation within the time frame specified in the corrective compliance plan. In paragraph (e)(1) of this section, we specified the fixed time frame in which a State must fully correct or discontinue the violation for two penalties: Failure to meet the minimum work participation rates and failure to comply with the five-year limit on the receipt of Federal TANF assistance. We have determined that the same fixed time frame should apply to this new penalty as well. Therefore, States subject to this penalty that elect to enter into a corrective compliance plan must fully correct the violation by the end of the first fiscal year ending at least six months after our receipt of the State's corrective compliance plan. We have added this penalty to § 262.6(e)(1). Also, we may require, on a case-by-case basis, an amendment to the State's verification procedures/plan as one of the steps the State must take to correct or discontinue the violation. We included this requirement at § 262.6(f).

States that are subject to a penalty for failure to meet one of the required minimum work participation rates also have the opportunity to claim reasonable cause, as specified at § 262.5. As a reminder, under the current process, States would not typically learn the results of the work participation rates for a fiscal year until the third or fourth quarter of the following year. For example, for FY 2007, after we receive the final quarter of State work participation data at the end of the first quarter of FY 2008, it will take several months to analyze the data and determine which States failed to meet the FY 2007 work participation rates and therefore are liable for a penalty. Any State that failed to meet one of the required rates then would receive a notice with several options, including, as noted above, requesting a reasonable cause exception from the penalty and entering into a corrective compliance plan to correct the violation fully. Please refer to the regulations at 45 CFR 262.4 *et seq.* for a complete explanation of that process.

We recognize that this interim final rule imposes new requirements on States, which, in some States, will require legislative action. We invite States that believe that it will be impossible to meet the work participation rates without State legislative action to submit comments explaining why it will be impossible to meet the required rates and how we should use the reasonable cause exception to provide relief from the work participation penalty.

Part 263—Expenditures of State and Federal TANF Funds

Subpart A—What Rules Apply to a State's Maintenance of Effort?

Section 263.2 What kinds of State expenditures count toward meeting a State's basic MOE expenditure requirement?

We made changes to the maintenance of effort regulations in § 263.2(a)(4) to reflect the impact of the provision in the Deficit Reduction Act of 2005 on counting spending for certain pro-family activities. Similarly, we clarified existing matching policy under a new § 263.2(e) and renumbered the former section (e) as section (f). We also added a new paragraph (g) to clarify that State funds used to meet any matching requirement under the Healthy Marriage Promotion and Responsible Fatherhood Grant may count to meet the MOE requirement in § 263.1.

As provided under PRWORA, States are subject to a cost-sharing amount known as the maintenance-of-effort (MOE) requirement. If a State fails to meet the required minimum all-family or two-parent work participation rate for a fiscal year, then the State must spend at least 80 percent of its FY 1994 historic State expenditures in that fiscal year. If the State meets both minimum work program participation rate requirements, then the required spending level decreases to 75 percent of its FY 1994 historic State expenditures.

Before the Deficit Reduction Act of 2005, States could only count toward their MOE requirement, expenditures to provide assistance, benefits, and/or services to or on behalf of eligible families, regardless of the TANF purpose that the expenditure is reasonably calculated to accomplish. Under our original rule, an ''eligible family'' must meet two fundamental criteria. First, the family must, at a minimum, consist of a child living with a custodial parent or other caretaker relative, or consist of a pregnant woman. Second, to receive benefits, the family must be financially needy according to the quantified income and resource (if applicable) criteria established by the State and contained in the State's TANF plan.

The Deficit Reduction Act of 2005 maintains the same MOE spending levels. However, the new law adds a provision ''Counting of Spending on Certain Pro-Family Activities'' at 409(a)(7)(B)(i)(V) of the Social Security Act. This provision allows States to count expenditures on pro-family activities, if the expenditure is reasonably calculated to prevent and reduce the incidence of out-of-wedlock births (TANF purpose three), or encourage the formation and maintenance of healthy two-parent married families (TANF purpose four).

This new provision allows States to claim for MOE all qualified pro-family expenditures for *non-assistance benefits and services* provided to or on behalf of an individual or family, regardless of financial need or family composition, if the activity is reasonably calculated to accomplish either TANF purpose three or TANF purpose four. We reflect this

new provision in the MOE regulation at § 263.2(a)(4). However, States must continue to limit the provision of Federal TANF and MOE-funded ''*assistance,*'' as defined in § 260.31(a) to eligible families, regardless of the TANF purpose.

Congress also created a new TANF discretionary funding stream (Grants for Healthy Marriage Promotion and Responsible Fatherhood) in the Deficit Reduction Act of 2005. Because Congress placed these funds in title IV–A of the Social Security Act, all State expenditures for allowable activities under the Healthy Marriage Promotion and Promoting Responsible Fatherhood programs specified in sections 403(a)(2)(A)(iii) and 403(a)(2)(C)(ii) of the Act may count toward the State's MOE requirement, unless a limitation, restriction or prohibition under this subpart applies.

Section 409(a)(7)(B)(iv)(IV) of the Act allows States to count expenditures made as a condition of receiving Federal funds under title IV, part A of the Social Security Act toward their MOE requirement. The Healthy Marriage Promotion Grants are under title IV, part A of the Social Security Act. Therefore, if grantees are required to contribute a matching share of the total approved costs of Healthy Marriage Promotion and Responsible Fatherhood projects under subsections 403(a)(2)(A)(iii) and 403(a)(2)(C)(ii) of the Act, then State expenditures made to meet any required non-Federal share may count toward the State's MOE requirement, provided the expenditure also meets all applicable MOE requirements, restrictions, and limitations. This provision is outlined in § 263.2(g).

The regulations at 45 CFR Part 92, which apply to the TANF program, cover matching or cost-sharing requirements. These rules permit States to count toward their MOE requirement non-Federal cash or in-kind qualified expenditures on allowable activities by a third party, provided there is an agreement to do so in writing by the two parties. We previously clarified this point in TANF Policy Announcement TANF–ACF–PA–2004–01, dated December 1, 2004. This may include Healthy Marriage and Responsible Fatherhood providers in a State to meet any required non-Federal share. In the interest of clarity, we have added a paragraph discussing the counting of third-party expenditures towards the MOE requirement at § 263.2(e). This amendment does not reflect a change in policy.

Section 263.6 What kinds of expenditures do not count?

The Deficit Reduction Act of 2005 does not change the prohibition at section 409(a)(7)(B)(iv)(IV) of the Act. Under this prohibition, States may not count expenditures made ''as a condition of receiving Federal funds *other than under this part*'' toward its TANF MOE requirement. However, paragraph (c) of our original rule does not accurately reflect this provision, as it stipulates that ''Expenditures that a state makes as a condition of receiving Federal funds under *another* program * * *'' may not count toward the State's MOE requirement. Therefore, we have corrected paragraph (c) to say that the prohibition applies to expenditures that a State makes as a condition of receiving Federal funds under another program that is not in Part IV–A of the Act. This should avoid any misunderstanding and ensure that States know that they may count the non-Federal share of expenditures on allowable activities under the healthy marriage promotion or promoting responsible fatherhood programs in sections 403(a)(2)(A)(iii) or 403(a)(2)(C)(ii) of the Act.

Part 265—Data Collection and Reporting Requirements

Under the TANF program, States must meet a number of specific data reporting requirements. Some of these reporting requirements are explicit, primarily in section 411(a) of the Social Security Act, while others are implicit. For example, States are the source of information for reports that the Secretary must submit to Congress and also for the accountability provisions and determination of penalties.

These data requirements support two complementary purposes: (1) They provide information about the effectiveness and success of States in meeting the TANF purposes; and (2) they assure State accountability for key programmatic requirements. In particular, they ensure measurement of State performance in achieving the work participation rates in section 407 and other objectives of the Social Security Act.

These purposes can only be achieved if data are comparable across States and over time. Section 411(a)(7) of the Social Security Act permits the Secretary to prescribe such regulations as may be necessary to define the data elements required in the reports mandated by section 411(a). This is one of the few places in which the TANF law requires regulation by the Secretary and therefore reflects the importance of collecting comparable data.

The data requirements of section 411(a) reflect particular features of the program which are important for measuring the success of TANF. States have collected and reported similar data on the characteristics, financial circumstances, and assistance received by families for many years. These data enable Congress and the public to observe how changes in welfare policies affect the demographic characteristics and the financial circumstances of families receiving assistance, as well as the self-sufficiency services provided by States. Similar data facilitate comparisons across States and over time and promotes better understanding of what is happening nationwide—how States are assisting needy families; how they are promoting job preparation, work, and marriage; what is happening to out-of-wedlock birth trends among assisted families; and what kinds of support two-parent families are receiving.

Section 411(a)(1)(A)(xii) of the Act specifically requires States to report on ''information necessary to calculate participation rates under section 407.'' Given the significance of the work rates for achieving the objectives of TANF and for determining whether States face penalties, this is an area where accurate and timely measurement is particularly important.

Our primary goal in implementing the data collection and reporting requirements of the Act is to collect the data necessary to monitor program performance or required by statute. A secondary goal of this interim final rule is to give States clear guidance about what these requirements entail and the consequences of failing to meet the requirements. At the same time, however, we are sensitive to the issue of paperwork burden and are committed to minimizing the reporting burden on States, consistent with the TANF statutory framework.

As an aid to States, we will continue to support personal computer-based software packages to facilitate data entry and to create transmission files for each quarterly data report. These system supports also provide some edits to ensure data consistency. The transmission files use a standard file format for electronic submission to ACF. For the aggregated sections of the quarterly reports, we have created web-based reporting systems that permit easy access to States for adding and modifying their aggregated quarterly data reports on-line.

As discussed under the Paperwork Reduction Act of 1995 (PRA) provisions

of this preamble, we have submitted copies of this interim final rule and data reporting requirements to the Executive Office of Management and Budget (OMB) for its review of the information collection requirements. We encourage States, organizations, individuals, and others to submit comments regarding the information collection requirements to ACF (at the address above) and to the Office of Information and Regulatory Affairs, OMB, Room 3208, New Executive Office Building, Washington, DC 20503, ATTN: ACF/HHS Desk Officer. We will make necessary revisions in these instruments following the comment period and will issue them to States through the ACF policy issuance system.

The following discussion provides information on the changes we have made in part 265. We discuss the specific new data elements and the statutory authority for the new data elements.

Section 265.1 What does this part cover?

Paragraph (c) specifies the quarterly report that must be filed by States that claim MOE expenditures for separate State program(s). Under the prior TANF regulation, the quarterly report for separate State programs was required only if a State wanted to qualify for a caseload reduction credit or receive a high performance bonus. Now, this report is mandatory as required by section 411(a)(1)(A) of the Act as modified by the Deficit Reduction Act of 2005. We discuss this report and the specific data elements in the report more fully in § 265.3 below.

Section 265.2 What definitions apply to this part?

In addition to the definition contained in this provision, the data collection and reporting regulations rely on the general TANF definitions in §§ 260.30 through 33 and the definitions of a work-eligible individual and the work activities in § 261.2.

Section 265.3 What reports must the State file on a quarterly basis?

Each State must file two reports on a quarterly basis—the TANF Data Report and the TANF Financial Report. Also, each State that claims MOE expenditures for a separate State program(s) must file an additional report on a quarterly basis—the SSP–MOE Data Report.

Under prior TANF regulations, we discussed the statutory authorities for the TANF Data Report data elements that States will continue to collect. Below, we discuss the statutory authorities for all newly required data elements of the TANF Data Report. However, for ease of understanding, we have included § 265.3 in the interim rule in its entirety.

Section 265.3(b)(1) TANF Data Report: Disaggregated Data—Section One

Paragraph (b)(1) of this section requires that each State file the disaggregated case record information, as specified in section 411(a) of the Act, on families receiving TANF assistance.

The information we require to be collected is, for the most part, the same information that was collected under the prior TANF regulations. However, we have made several changes to the prior data collection instrument. We added a data element to identify work-eligible individuals for calculating the work participation rates. The statutory authority for the new data element comes from Sections 407(i) and 411(a)(1)(A)(xii) of the Social Security Act. We modified the definition of a two-parent family for work participation rate purposes and the instructions to the data element, Type of Family for Work Participation, to reflect the work-eligible individual concept. As clarification, we have also included the definitions of each work activity as defined at § 261.2.

Section 265.3(b)(4) TANF Data Report: Aggregated Data—Section Four

Paragraph (b)(4) of this section requires that each State that opts to report data for sections one and/or two based on a stratified sample must file quarterly aggregated caseload data by stratum for each month of the quarter. We did not explicitly regulate on submitting section four of the TANF Data Report under prior TANF regulation. However, it was implicit in prior TANF regulations as we did require States to follow the procedures in the TANF Sampling Manual in reporting data based on samples. The TANF Sampling Manual required States that used stratified sampling to report the information in section four of the TANF Data Report. Section four of the TANF Data Report was issued on January 19, 2000 in TANF–ACF–PI–2000–1 along with the TANF Sampling Manual. The only change we are making to section four is one additional code to designate whether the caseload data for a stratum is for section one or for section two of the TANF Data Report.

Section 265.3(d) SSP–MOE Data Report

Paragraph (d) requires a State that claims MOE expenditures for a separate State program(s) to report case record data on separate MOE programs. This implements the Deficit Reduction Act of 2005 changes to section 411(a)(1)(A) of the Act.

The data elements we are requiring States to collect on separate State programs are identical in content to, but fewer in number than the demographic and work activity data we are requiring in paragraph (b) of this section and are unchanged except as explained under the revised individual SSP–MOE Data Report sections below.

Section 265.3(d)(1) SSP–MOE Data Report: Disaggregated Data—Section One

Paragraph (d)(1) requires that each State that claims MOE expenditures for a separate State program(s) file the disaggregated case record information, as specified in section 411(a) of the Act, on families receiving SSP–MOE assistance.

Generally, the information we require to be reported is the same information that was collected under the prior TANF regulations. There are several changes to the prior data collection instrument. We have added a data element to identify work-eligible individuals for calculating the work participation rates. The statutory authority for the new data element comes from sections 407(i) and 411(a)(1)(A)(xii) of the Social Security Act. We modified the definition of a two-parent family for work participation rate purposes and the instructions to the data element, Type of Family for Work Participation, to reflect the work-eligible individual concept. As clarification, we have also included the definitions of each work activity as defined at § 261.2.

Section 265.3(d)(2) SSP–MOE Data Report: Disaggregated Data—Section Two

Paragraph (d)(2) of this section requires that each State that claims MOE expenditures for a separate State program(s) file the disaggregated case record information, as specified in section 411(a) of the Act, on families no longer receiving SSP–MOE assistance.

The second section of the SSP–MOE Data Report contains 28 data elements applicable to families no longer receiving assistance. The data elements in section two are identical to those in section one and are unchanged from the data elements collected in this section under prior TANF regulations.

Section 265.3(d)(3) SSP–MOE Data Report: Aggregated Data—Section Three

Paragraph (d)(3) of this section requires that each State that claims MOE expenditures for a separate State program(s) file quarterly aggregated information.

This third section of the SSP–MOE Data Report contains twelve data elements. These data elements are unchanged from what we collected under prior TANF regulations.

Section 265.3(d)(4) SSP–MOE Data Report: Aggregated Data—Section Four

Paragraph (d)(4) of this section requires that each State that claims MOE expenditures for a separate State program(s) and that opts to report data for sections one and/or two of the SSP–MOE Data Report based on a stratified sample file quarterly aggregated caseload data by stratum for each month in the quarter. We did not explicitly regulate on submitting section four of the SSP–MOE Data Report under prior TANF regulation. However, it was implicit in prior regulations as we did require States to follow the procedures in the TANF Sampling Manual in reporting data based on samples. The TANF Sampling Manual required States that used stratified sampling to report the information in section four of the SSP–MOE Data Report. Section four of the SSP–MOE Data Report was issued on January 19, 2000 in TANF–ACF–PI–2000–1 along with the TANF Sampling Manual. The only change to section four is one additional code to designate whether the caseload data for a stratum is for section one or for section two of the SSP–MOE Data Report.

Section 265.4 When are quarterly reports due?

For States that claim MOE expenditures for separate State program(s), revised paragraph (b) of this section implements section 409(a)(2) of the Act which requires that States file quarterly reports within 45 days following the end of the fiscal quarter or be subject to a penalty. Under the prior regulations, the quarterly SSP–MOE Data Report was required only if a State wanted to qualify for a caseload reduction credit or receive a high performance bonus. Under the Deficit Reduction Act of 2005, section 411(a)(1)(A) of the Social Security Act now requires that States report quarterly on their separate State program(s) for which they claim MOE expenditures.

Section 265.8 Under what circumstances will a State be subject to a reporting penalty for failure to submit quarterly reports?

Under the interim final rule, the SSP–MOE Data Report is now included as a required quarterly report. Failure to submit this report by the due dates may subject the State to a reporting penalty as required by section 409(a)(2) of the Act and revised section 411(a)(1)(A) of the Act. This change is reflected in § 265.8(a)(1) and § 265.8(b). We also changed this section to remove the penalty trigger previously located at § 265.8(c) if a State fails to include the definitions of work activities in its annual report. This information is now required as part of the Work Verification Plan. For ease of understanding, we have included the revised section in its entirety.

IV. Paperwork Reduction Act

This rule contains information collection requirements that have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (PRA). Under this Act, no persons are required to respond to a collection of information unless it displays a valid OMB control number. If you have any comments on these information collection requirements, please submit them to OMB within 30 days. The address is: Office of Management and Budget, Paperwork Reduction Project, 725 17th Street, NW., Washington, DC 20503, Attn: ACF/HHS Desk Officer.

This interim final rule imposes some new requirements and modifies others. They are:

- A new requirement that States establish documentation, verification and internal control procedures to ensure valid work participation rates, based on regulatory specifications. States will be required to submit the procedures to HHS no later than September 30, 2006. We will review the procedures and approve them if they meet the requirements. If the procedures fail to address or meet the requirements, States will be given 60 days to revise and correct them. If a State fails to establish, submit, or correct the procedures within specified timeframes, the State will be liable for a full five percent penalty for the year.
- A modification and reduction in burden of the caseload reduction credit information collection based on the recalibration of the caseload reduction credit.
- A modification of the reasonable cause/corrective compliance information collection burden based on the requirements of the participation rate verification procedures.
- A modification of the TANF Data Report and the SSP–MOE Data Report based on how we define work-eligible individuals, especially with regard to child-only cases.

The estimated burdens for these data collections (existing burden plus additional burden) are:

Instrument or requirement	Number of respondents	Yearly submittals	Average burden hours per response	Total burden hours	Original total burden hours
Preparation and Submission of Data Verification Procedures—§§ 261.60–261.63.	54	1	640	34,560	Not Applicable.
Caseload Reduction Documentation Process, ACF–202—§§ 261.41 & 261.44.	54	1	120	6,480	8,640.
Reasonable Cause/Corrective Compliance Documentation Process—§§ 262.4, 262.6, & 262.7; § 261.51.	54	2	240	25,920	17,280.
TANF Data Report—Part 265	54	4	2,193	473,688	465,169.
SSP–MOE Data Report—Part 265	29	4	714	82,824	78,213.

We are submitting this information collection to OMB for approval. These requirements will not become effective until approved by OMB. Copies of the proposed collection may be obtained by writing to the Administration for Children and Families, Office of Administration, Office of Information Services, 370 L'Enfant Promenade, SW., Washington, DC 20447, Attn: ACF Reports Clearance Officer. All requests should be identified by the title of the information collection. E-mail address: *rsargis@acf.hhs.gov* Written comments to OMB for the information collection should be sent directly to: Office of Management and Budget, Paperwork Reduction Project, 725 17th Street, NW., Washington, DC 20503, Attn: Desk Officer for the Administration for Children and Families.

V. Regulatory Flexibility Analysis

The Secretary certifies, under 5 U.S.C. 605(b), as enacted by the Regulatory Flexibility Act (Pub. L. 96–354), that this interim final rule will not result in

a significant impact on a substantial number of small entities. The primary impact of these rules is on State governments and on the operation of the Federal Government. Neither is considered a small entity under the Regulatory Flexibility Act.

In developing this interim final rule, we sought to implement the new requirements of the Deficit Reduction Act of 2005 in a way that does not impinge on a State's ability to design effective and responsive programs. At the same time, we sought to address concerns about inconsistency of work measures among States and to focus renewed attention on strengthening efforts to help more low-income families enter the workforce and succeed at work. We considered alternatives along the spectrum of these goals and believe the policies adopted in this interim final rule achieve a balance between the aims of the DRA to improve effectiveness of the program and preserving States' ability to continue using creativity and ingenuity to help families succeed under the TANF work goals and objectives. The balance we strove to attain encompassed such issues as: how to count and verify allowable work activities; who is a work-eligible individual; and how to ensure that State internal control procedures will result in accurate and consistent work participation information.

In determining how to count and verify allowable work activities, we considered establishing a single documentation standard in which States would verify an individual's participation in work activities each day. We rejected this alternative as excessive and cumbersome for States to implement; moreover we feared it might discourage employers from hiring TANF recipients, thus undermining the program. Instead, as we describe above, we chose a set of guidelines that allows variation in documentation by the type of work activity in question. Not only does this let a State tailor its documentation procedures to the nature of the activity, but also it approximates the standards in the working world.

With regard to the definition of a work-eligible individual, we considered a range of alternatives looking at each type of family in which a parent resides with a child recipient of assistance to determine whether it was appropriate to include that group of families in the calculation of the work participation rates. As we examined each of these types of families, we considered the ability of each to work and sought to balance this ability to work with the need for consistent work participation rates as envisioned under the Deficit Reduction Act and State flexibility.

As an alternative to our regulatory approach to monitoring State internal control procedures for verifying work participation information, we considered developing a system in which we would regularly draw one or more samples of cases and validate critical data needed to calculate the work participation rates, using an error percentage as a means of determining whether a State might be liable for a work verification penalty. Ultimately, we decided this alternative would be too burdensome, reminiscent of quality control systems of the past. We determined that the best approach was to describe in detail what we expect States to include in the Work Verification Plan and then to use the existing audit process as the principal means of assessing the accuracy of work participation data. We discuss this approach to regulating in greater detail throughout the preamble to these rules.

VI. Regulatory Impact Analysis

Executive Order 12866 requires that regulations be reviewed to ensure that they are consistent with the priorities and principles set forth in the Executive Order. The Department has determined that this interim final rule is consistent with these priorities and principles. These regulations primarily implement statutory changes to TANF included in the Deficit Reduction Act of 2005.

VII. Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that a covered agency prepare a budgetary impact statement before promulgating a rule that includes any Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year.

If an agency must prepare a budgetary impact statement, section 205 requires that it select the most cost-effective and least burdensome alternative that achieves the objectives of the rule consistent with the statutory requirements. Section 203 requires a plan for informing and advising any small government that may be significantly or uniquely impacted.

The Department has determined that this interim final rule, in implementing the new statutory requirements, would not impose a mandate that will result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of more than $100 million in any one year. In enacting the provisions of the Deficit Reduction Act, the Congress maintained the basic funding structure and flexibility of the TANF program. Over each of the next five years, the TANF block grant will provide States with $16.5 billion in Federal funds and a total of over $27 billion annually when including State Maintenance of Effort (MOE) funding. With the continued commitment of full funding for TANF, along with $2.1 billion in reported unobligated TANF balances at the end of FY 2005, States will have the resources to successfully meet the requirements of the Deficit Reduction Act. The funding level for States remains fixed and is based on historic levels of welfare spending when states used to serve a cash-dependent welfare caseload of more than twice its current size. States retain significant flexibility in the use of their TANF dollars to design their programs and have wide flexibility to determine eligibility criteria, benefit levels and the type of services and benefits available to TANF recipients.

In addition, over five years (FYs 2007–2011), the Department estimates that the States will pay penalties of $51 million due to failure to meet work requirements. In general, our estimate assumes that most States will meet the work participation rates, because States retain considerable programmatic flexibility, along with increased motivation to develop a stronger focus on moving people to work and more accurate reporting systems. For those States that fail to meet work participation requirements, we do not anticipate assessing penalties until FY 2009. Once penalty liability is identified States will have an opportunity to correct the problem prior to the assessment of a penalty. We estimate issuing penalties amounting to $7 million in FY 2009, $16 million in FY 2010 and $28 million in FY 2011. Our estimated penalty assessment level increases during this period, in part, because the penalty percentage rate is progressive. Accordingly, we have not prepared a budgetary impact statement or prepared a plan for informing impacted small governments.

VIII. Congressional Review

This regulation is not a major rule as defined in 5 U.S.C. Chapter 8.

IX. Assessment of Federal Regulation and Policies on Families

Section 654 of the Treasury and General Government Appropriations Act of 1999 requires Federal agencies to determine whether a proposed policy or regulation may negatively affect family well being. If the agency's determination

is affirmative, then the agency must prepare an impact assessment addressing seven criteria specified in the law. The Department has conducted a Family Policymaking Assessment in accordance with this requirement and determined that these regulations will not have a negative impact on family well being as defined in the legislation.

X. Executive Order 13132

Executive Order 13132, Federalism, requires that Federal agencies consult with State and local government officials in the development of regulatory policies with federalism implications. Consistent with Executive Order 13132, we specifically solicit comment from State and local government officials on this interim final rule. We will seriously consider these comments in developing the final rule.

List of Subjects

45 CFR Parts 261 and 262

Administrative practice and procedure, Day care, Employment, Grant programs-social programs, Penalties, Public assistance programs, Reporting and recordkeeping requirements, Vocational education.

45 CFR Part 263

Administrative practice and procedure, Day care, Employment, Grant programs-social programs, Loan programs-social programs, Penalties, Public assistance programs.

45 CFR Part 265

Administrative practice and procedure, Day care, Employment, Grant programs-social programs, Penalties, Public assistance programs, Reporting and recordkeeping requirements.

Dated: March 23, 2006.

Wade F. Horn,

Assistant Secretary for Children and Families.

Approved: May 25, 2006.

Michael O. Leavitt,

Secretary of Health and Human Services.

For the reasons stated in the preamble, we are amending 45 CFR chapter II by revising part 261, part 262, part 263, and part 265 as set forth below:

■ 1. The authority citation for part 261 is revised to read as follows:

Authority: 42 U.S.C. 601, 602, 607, and 609; Pub. L. 109–171.

■ 2. Revise § 261.1 to read as follows:

§ 261.1 What does this part cover?

This part includes the regulatory provisions relating to the mandatory work requirements of TANF and State work participation data verification requirements.

■ 3. Revise § 261.2 to read as follows:

§ 261.2 What definitions apply to this part?

(a) The general TANF definitions at §§ 260.30 through 260.33 of this chapter apply to this part.

(b) *Unsubsidized employment* means full-or part-time employment in the public or private sector that is not subsidized by TANF or any other public program.

(c) *Subsidized private sector employment* means employment in the private sector for which the employer receives a subsidy from TANF or other public funds to offset some or all of the wages and costs of employing a recipient.

(d) *Subsidized public sector employment* means employment in the public sector for which the employer receives a subsidy from TANF or other public funds to offset some or all of the wages and costs of employing a recipient.

(e) *Work experience (including work associated with the refurbishing of publicly assisted housing) if sufficient private sector employment is not available* means a work activity, performed in return for welfare, that provides an individual with an opportunity to acquire the general skills, training, knowledge, and work habits necessary to obtain employment. The purpose of work experience is to improve the employability of those who cannot find unsubsidized employment. This activity must be supervised by an employer, work site sponsor, or other responsible party on an ongoing basis no less frequently than daily.

(f) *On-the-job training* means training in the public or private sector that is given to a paid employee while he or she is engaged in productive work and that provides knowledge and skills essential to the full and adequate performance of the job. On-the-job training must be supervised by an employer, work site sponsor, or other responsible party on an ongoing basis no less frequently than daily.

(g) *Job search and job readiness assistance* means the act of seeking or obtaining employment, preparation to seek or obtain employment, including life skills training, and substance abuse treatment, mental health treatment, or rehabilitation activities for those who are otherwise employable. Such treatment or therapy must be determined to be necessary and certified by a qualified medical or mental health professional. Job search and job readiness assistance activities must be supervised by the TANF agency or other responsible party on an ongoing basis no less frequently than daily.

(h) *Community service programs* mean structured programs and embedded activities in which TANF recipients perform work for the direct benefit of the community under the auspices of public or nonprofit organizations. Community service programs must be limited to projects that serve a useful community purpose in fields such as health, social service, environmental protection, education, urban and rural redevelopment, welfare, recreation, public facilities, public safety, and child care. Community service programs are designed to improve the employability of recipients not otherwise able to obtain employment, and must be supervised on an ongoing basis no less frequently than daily. A State agency shall take into account, to the extent possible, the prior training, experience, and skills of a recipient in making appropriate community service assignments.

(i) *Vocational educational training (not to exceed 12 months with respect to any individual)* means organized educational programs that are directly related to the preparation of individuals for employment in current or emerging occupations requiring training other than a baccalaureate or advanced degree. Vocational educational training must be supervised on an ongoing basis no less frequently than daily.

(j) *Job skills training directly related to employment* means training or education for job skills required by an employer to provide an individual with the ability to obtain employment or to advance or adapt to the changing demands of the workplace. Job skills training directly related to employment must be supervised on an ongoing basis no less frequently than daily.

(k) *Education directly related to employment, in the case of a recipient who has not received a high school diploma or a certificate of high school equivalency* means education related to a specific occupation, job, or job offer. Education directly related to employment must be supervised on an ongoing basis no less frequently than daily.

(l) *Satisfactory school attendance at secondary school or in a course of study leading to a certificate of general equivalence, in the case of a recipient who has not completed secondary school or received such a certificate* means regular attendance, in accordance with the requirements of the secondary school or course of study, at a secondary school or in a course of study leading to a certificate of general equivalence, in

the case of a recipient who has not completed secondary school or received such a certificate. This activity must be supervised on an ongoing basis no less frequently than daily.

(m) *Providing child care services to an individual who is participating in a community service program* means providing child care to enable another TANF recipient to participate in a community service program. This activity must be supervised on an ongoing basis no less frequently than daily.

(n)(1) *Work-eligible individual* means an adult (or minor child head-of-household) receiving assistance under TANF or a separate State program or a non-recipient parent living with a child receiving such assistance unless the parent is:

(i) A minor parent and not the head-of-household or spouse of the head-of-household;

(ii) An alien who is ineligible to receive assistance due to his or her immigration status; or

(iii) At State option on a case-by-case basis, a recipient of Supplemental Security Income (SSI) benefits.

(2) The term also excludes:

(i) A parent providing care for a disabled family member living in the home who does not attend school on a full-time basis, provided that the need for such care is supported by medical documentation; and

(ii) An individual in a family receiving MOE-funded assistance under an approved Tribal TANF program, unless the State includes the Tribal family in calculating work participation rates, as permitted under section 261.25.

■ 4. Revise Subpart B to read as follows:

Subpart B—What Are the Provisions Addressing State Accountability?

Sec.

§ 261.20 How will we hold a State accountable for achieving the work objectives of TANF?

(a) Each State must meet two separate work participation rates in FY 2006 and thereafter, one—the two-parent rate based on how well it succeeds in helping work-eligible individuals in two-parent families find work activities described at § 261.30, the other—the overall rate based on how well it succeeds in finding those activities for work-eligible individuals in all the families that it serves.

(b) Each State must submit data, as specified at § 265.3 of this chapter, that allows us to measure its success in requiring work-eligible individuals to participate in work activities.

(c) If the data show that a State met both participation rates in a fiscal year, then the percentage of historic State expenditures that it must expend under TANF, pursuant to § 263.1 of this chapter, decreases from 80 percent to 75 percent for that fiscal year. This is also known as the State's TANF ''maintenance-of-effort'' (MOE) requirement.

(d) If the data show that a State did not meet a minimum work participation rate for a fiscal year, a State could be subject to a financial penalty.

(e) Before we impose a penalty, a State will have the opportunity to claim reasonable cause or enter into a corrective compliance plan, pursuant to §§ 262.5 and 262.6 of this chapter.

§ 261.21 What overall work rate must a State meet?

Each State must achieve a 50 percent minimum overall participation rate in FY 2006 and thereafter, minus any caseload reduction credit to which it is entitled as provided in subpart D of this part.

§ 261.22 How will we determine a State's overall work rate?

(a)(1) The overall participation rate for a fiscal year is the average of the State's overall participation rates for each month in the fiscal year.

(2) The rate applies to families with a work-eligible individual.

(b) We determine a State's overall participation rate for a month as follows:

(1) The number of TANF and SSP–MOE families that include a work-eligible individual who meet the requirements set forth in § 261.31 for the month (*i.e.*, the numerator), divided by,

(2) The number of TANF and SSP–MOE families that include a work-eligible individual, minus the number of such families that are subject to a penalty for refusing to work in that month (*i.e.*, the denominator). However, if a family with a work-eligible individual has been penalized for refusal to participate in work activities for more than three of the last 12 months, we will not exclude it from the participation rate calculation.

(3) At State option, we will include in the participation rate calculation families with a work-eligible individual that have been penalized for refusing to work no more than three of the last 12 months.

(c)(1) A State has the option of not requiring a single custodial parent caring for a child under age one to engage in work.

(2) At State option, we will disregard a family with such a parent from the participation rate calculation for a maximum of 12 months.

(d)(1) If a family receives assistance for only part of a month, we will count it as a month of participation if a work-eligible individual is engaged in work for the minimum average number of hours in each full week that the family receives assistance in that month.

(2) If a State pays benefits retroactively (*i.e.*, for the period between application and approval of benefits), it has the option to consider the family to be receiving assistance during the period of retroactivity.

§ 261.23 What two-parent work rate must a State meet?

Each State must achieve a 90 percent minimum two-parent participation rate in FY 2006 and thereafter, minus any caseload reduction credit to which it is entitled as provided in subpart D of this part.

§ 261.24 How will we determine a State's two-parent work rate?

(a)(1) The two-parent participation rate for a fiscal year is the average of the State's two-parent participation rates for each month in the fiscal year.

(2) The rate applies to two-parent families with two work-eligible individuals. However, if one of the parents is a disabled work-eligible individual, we will not consider the family to be a two-parent family; *i.e.*, we will not include such a family in either the numerator or denominator of the two-parent rate.

(b) We determine a State's two-parent participation rate for the month as follows:

(1) The number of two-parent TANF and SSP–MOE families in which both parents are work-eligible individuals and together they meet the requirements set forth in § 261.32 for the month (*i.e.*, the numerator), divided by,

(2) The number of two-parent TANF and SSP–MOE families in which both parents are work-eligible individuals during the month, minus the number of such two-parent families that are subject to a penalty for refusing to work in that month (the denominator). However, if a family with a work-eligible individual has been penalized for more than three months of the last 12 months, we will

not exclude it from the participation rate calculation.

(3) At State option, we will include in the participation rate calculation families with a work-eligible individual that have been penalized for refusing to work no more than three of the last 12 months.

(c) For purposes of the calculation in paragraph (b) of this section, a two-parent family includes, at a minimum, all families with two natural or adoptive parents (of the same minor child) who are work-eligible individuals and living in the home, unless both are minors and neither is a head-of-household.

(d)(1) If the family receives assistance for only part of a month, we will count it as a month of participation if a work-eligible individual in the family (or both work-eligible individuals, if they are both required to work) is engaged in work for the minimum average number of hours in each full week that the family receives assistance in that month.

(2) If a State pays benefits retroactively (*i.e.*, for the period between application and approval of benefits), it has the option to consider the family to be receiving assistance during the period of retroactivity.

§ 261.25 Does a State include Tribal families in calculating the work participation rate?

At State option, we will include families with a work-eligible individual that are receiving assistance under an approved Tribal family assistance plan or under a Tribal work program in calculating the State's participation rates under §§ 261.22 and 261.24.

■ 5. Revise § 261.31 to read as follows:

§ 261.31 How many hours must a work-eligible individual participate for the family to count in the numerator of the overall rate?

(a) A work-eligible individual counts as engaged in work for a month for the overall rate if:

(1) He or she participates in work activities during the month for at least a minimum average of 30 hours per week; and

(2) At least 20 of the above hours per week come from participation in the activities listed in paragraph (b) of this section.

(b) The following nine activities count toward the first 20 hours of participation: Unsubsidized employment; subsidized private-sector employment; subsidized public-sector employment; work experience; on-the-job training; job search and job readiness assistance; community service programs; vocational educational training; and providing child care services to an individual who is participating in a community service program.

(c) Above 20 hours per week, the following three activities may also count as participation: Job skills training directly related to employment; education directly related to employment; and satisfactory attendance at secondary school or in a course of study leading to a certificate of general equivalence.

(d) We will consider a work-eligible individual who participates in a work experience or community service program for the maximum number of hours per week that a State may require by dividing the combined monthly TANF grant and food stamp allotment by the appropriate minimum wage under the minimum wage requirement of the Fair Labor Standards Act (FLSA) to have participated 20 hours per week if actual participation falls short of 20 hours per week. This policy is limited to States that have adopted a food stamp workfare program and a Simplified Food Stamp Program. For families that need additional hours beyond the core activity requirement, these hours must be satisfied in some other TANF work activity.

■ 6. Revise § 261.32 to read as follows:

§ 261.32 How many hours must work-eligible individuals participate for the family to count in the numerator of the two-parent rate?

(a) Subject to paragraph (d) of this section, a family with two work-eligible parents counts as engaged in work for the month for the two-parent rate if:

(1) Work-eligible parents in the family are participating in work activities for a combined average of at least 35 hours per week during the month, and

(2) At least 30 of the 35 hours per week come from participation in the activities listed in paragraph (b) of this section.

(b) The following nine activities count for the first 30 hours of participation: Unsubsidized employment; subsidized private-sector employment; subsidized public-sector employment; work experience; on-the-job training; job search and job readiness assistance; community service programs; vocational educational training; and providing child care services to an individual who is participating in a community service program.

(c) Above 30 hours per week, the following three activities may also count for participation: Job skills training directly related to employment; education directly related to employment; and satisfactory attendance at secondary school or in a course of study leading to a certificate of general equivalence.

(d) We will consider a family with two work-eligible parents in which one or both parents participate in a work experience or community service program for the maximum number of hours per week that a State may require by dividing their combined monthly TANF grant and food stamp allotment by the appropriate minimum wage under the minimum wage requirement of the Fair Labor Standards Act (FLSA) to have participated 30 hours per week if actual participation falls short of 30 hours per week. This policy is limited to States that have adopted a food stamp workfare program and a Simplified Food Stamp Program. For families that need additional hours beyond the core activity requirement, these hours must be satisfied in some other TANF work activity.

(e)(1) 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 work-eligible individuals must be participating in work activities for an average of at least 55 hours per week to count as a two-parent family engaged in work for the month.

(2) At least 50 of the 55 hours per week must come from participation in the activities listed in paragraph (b) of this section.

(3) Above 50 hours per week, the three activities listed in paragraph (c) of this section may also count as participation.

(4) We will consider family with two work-eligible parents receiving federally funded child care in which one or both parents participate in a work experience or community service program for the maximum number of hours per week that a State may require by dividing their combined monthly TANF grant and food stamp allotment by the appropriate minimum wage under the minimum wage requirement of the Fair Labor Standards Act (FLSA) to have participated 50 hours per week if actual participation falls short of 50 hours per week. This policy is limited to States that have adopted a food stamp workfare program and a Simplified Food Stamp Program. For families that need additional hours beyond the core activity requirement, these hours must be satisfied in some other TANF work activity.

■ 7. Revise Subpart D to read as follows:

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

Sec.

§ 261.40 Is there a way for a State to reduce the work participation rates?

(a)(1) If the average monthly number of cases receiving assistance, including assistance under a separate State program (as provided at § 261.42(b)), in a State in the preceding fiscal year was lower than the average monthly number of cases that received assistance, including assistance under a separate State program in that State in FY 2005, the minimum overall participation rate the State must meet for the fiscal year (as provided at § 261.21) decreases by the number of percentage points the prior-year caseload fell in comparison to the FY 2005 caseload.

(2) The minimum two-parent participation rate the State must meet for the fiscal year (as provided at § 261.23) decreases, at State option, by either:

(i) The number of percentage points the prior-year two-parent caseload, including two-parent cases receiving assistance under a separate State program (as provided at § 261.42(b)), fell in comparison to the FY 2005 two-parent caseload, including two-parent cases receiving assistance under a separate State program; or

(ii) The number of percentage points the prior-year overall caseload, including assistance under a separate State program (as provided at § 261.42(b)), fell in comparison to the FY 2005 overall caseload, including cases receiving assistance under a separate State program.

(3) For the credit calculation, we will refer to the fiscal year that precedes the fiscal year to which the credit applies as the ''comparison year.''

(b)(1) The calculations in paragraph (a) of this section must disregard caseload reductions due to requirements of Federal law and to changes that a State has made in its eligibility criteria in comparison to its criteria in effect in FY 2005.

(2) At State option, the calculation may offset the disregard of caseload reductions in paragraph (b)(1) of this section by changes in eligibility criteria that increase caseloads.

(c)(1) To establish the caseload base for FY 2005 and to determine the comparison-year caseload, we will use the combined TANF and Separate State Program caseload figures reported on the Form ACF–199, TANF Data Report, and Form ACF–209, SSP–MOE Data Report, respectively.

(2) To qualify for a caseload reduction, a State must have reported monthly caseload information, including cases in separate State programs, for FY 2005 and the comparison year for cases receiving assistance as defined at § 261.43.

(d)(1) A State may correct erroneous data or submit accurate data to adjust program data or to include unduplicated cases within the fiscal year.

(2) We will adjust both the FY 2005 baseline and the comparison-year caseload information, as appropriate, based on these State submissions.

(e) We refer to the number of percentage points by which a caseload falls, disregarding the cases described in paragraph (b), as a caseload reduction credit.

§ 261.41 How will we determine the caseload reduction credit?

(a)(1) We will determine the overall and two-parent caseload reduction credits that apply to each State based on the information and estimates reported to us by the State on eligibility policy changes using application denials, case closures, or other administrative data sources and analyses.

(2) We will accept the information and estimates provided by a State, unless they are implausible based on the criteria listed in paragraph (d) of this section.

(3) We may conduct on-site reviews and inspect administrative records on applications, case closures, or other administrative data sources to validate the accuracy of the State estimates.

(b) In order to receive a caseload reduction credit, a State must submit a Caseload Reduction Report to us containing the following information:

(1) A listing of, and implementation dates for, all State and Federal eligibility changes, as defined at § 261.42, made by the State since the beginning of FY 2006;

(2) A numerical estimate of the positive or negative average monthly impact on the comparison-year caseload of each eligibility change (based, as appropriate, on application denials, case closures or other analyses);

(3) An overall estimate of the total net positive or negative impact on the applicable caseload as a result of all such eligibility changes;

(4) An estimate of the State's caseload reduction credit;

(5) A description of the methodology and the supporting data that a State used to calculate its caseload reduction estimates; and

(6) A certification that it has provided the public an appropriate opportunity to comment on the estimates and methodology, considered their comments, and incorporated all net reductions resulting from Federal and State eligibility changes.

(c)(1) A State requesting a caseload reduction credit for the overall participation rate must base its estimates of the impact of eligibility changes on decreases in its comparison-year overall caseload compared to the FY 2005 overall caseload baseline established in accordance with § 261.40(d).

(2) A State requesting a caseload reduction credit for its two-parent rate must base its estimates of the impact of eligibility changes on decreases in either:

(i) Its two-parent caseload compared to the FY 2005 comparison-year two-parent caseload baseline established in accordance with § 261.40(d); or

(ii) Its overall caseload compared to the FY 2005 comparison-year overall caseload baseline established in accordance with § 261.40(d).

(d)(1) For each State, we will assess the adequacy of information and estimates using the following criteria: its methodology; its estimates of impact compared to other States; the quality of its data; and the completeness and adequacy of its documentation.

(2) If we request additional information to develop or validate estimates, the State may negotiate an appropriate deadline or provide the information within 30 days of the date of our request.

(3) The State must provide sufficient data to document the information submitted under paragraph (b) of this section.

(e) We will not calculate a caseload reduction credit unless the State reports case-record data on individuals and families served by any separate State program, as required under § 265.3(d) of this chapter.

(f) A State may only apply to the participation rate a caseload reduction credit that we have calculated. If a State disagrees with the caseload reduction credit, it may appeal the decision as an adverse action in accordance with § 262.7 of this chapter.

§ 261.42 Which reductions count in determining the caseload reduction credit?

(a)(1) A State's caseload reduction credit must not include caseload decreases due to Federal requirements or State changes in eligibility rules since

FY 2005 that directly affect a family's eligibility for assistance.

(2) At State option, a State's caseload reduction credit may include caseload increases due to Federal requirements or State change in eligibility rules since FY 2005 if used to offset caseload decreases in paragraph (a)(1) of this section.

(3) A State may not receive a caseload reduction credit that exceeds the actual caseload decline between FY 2005 and the comparison year.

(4) 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.

(b) A State must include cases receiving assistance in separate State programs as part of its FY 2005 caseload and comparison-year caseload. However, if a State provides documentation that separate State program cases overlap with or duplicate cases in the TANF caseload, we will exclude them from the caseload count.

§ 261.43 What is the definition of a ''case receiving assistance'' in calculating the caseload reduction credit?

(a) The caseload reduction credit is based on decreases in caseloads receiving assistance (other than those excluded pursuant to § 261.42) both in a State's TANF program and in separate State programs that address basic needs and are used to meet the MOE requirement.

(b) A State that is investing State MOE funds in eligible families in excess of the required 80 percent or 75 percent basic MOE amount need only include the pro rata share of caseloads receiving assistance that is required to meet basic MOE requirements.

§ 261.44 When must a State report the required data on the caseload reduction credit?

A State must report the necessary documentation on caseload reductions for the preceding fiscal year by December 31.

Subpart F—[Redesignated as Subpart H]

■ 8. Redesignate Subpart F as subpart H.

§ 261.60 [Redesignated as § 261.80.]

■ 9. Redesignate § 261.60 as § 261.80.

■ 10. Add a new subpart F to read as follows:

Subpart F—How Do We Ensure the Accuracy of Work Participation Information?

Sec.

§ 261.60 What methods may a State use to report a work-eligible individual's hours of participation?

(a) A State must report the actual hours that an individual participates in an activity, subject to the qualifications in paragraphs (b) and (c) and § 261.61(c). It is not sufficient to report the hours an individual is scheduled to participate in an activity.

(b) For the purposes of calculating the work participation rates, actual hours may include the hours for which an individual was paid, including paid holidays and sick leave. For participation in unpaid work activities, it may also include excused absences for hours missed due to holidays and a maximum of an additional 10 days of excused absences in any 12-month period, no more than two of which may occur in a month. In order to count an excused absence as actual hours of participation, the individual must have been scheduled to participate in an allowable work activity for the period of the absence that the State reports as participation. A State must describe its excused absence policies and definitions as part of its Work Verification Plan, specified at § 261.62.

(c) A State may not count more hours toward the participation rate for a self-employed individual than the number derived by dividing the individual's self-employment income (gross income less business expenses) by the Federal minimum wage. A State may propose an alternative method of determining self-employment hours as part of its Work Verification Plan.

§ 261.61 How must a State document a work-eligible individual's hours of participation?

(a) A State must support each individual's hours of participation through documentation in the case file. In accordance with § 261.62, a State must describe in its Work Verification Plan the documentation it uses to verify hours of participation in each activity.

(b) For an employed individual, the documentation may consist of, but is not limited to pay stubs, employer reports, or time and attendance records substantiating hours of participation. A State may presume that an employed individual participated in unsubsidized employment for the total number of hours for which that individual was paid.

(c) For unsubsidized employment, subsidized employment, and OJT, a State may report projected actual hours of employment participation for up to six months based on current, documented actual hours of work. Any time a State receives information that the client's actual hours of work have changed, or no later than the end of any six-month period, the State must re-verify the client's current actual average hours of work, and may report these projected actual hours of participation for another six-month period.

(d) For an individual who is not employed, the documentation for substantiating hours of participation may consist of, but is not limited to, time sheets, service provider attendance records, or school attendance records.

(e) For an individual who is self-employed, the documentation must comport with standards set forth in the State's approved Work Verification Plan. Self-reporting by a participant without additional verification is not sufficient documentation.

§ 261.62 What must a State do to verify the accuracy of its work participation information?

(a) To ensure accuracy in the reporting of work activities by work-eligible individuals on the TANF Data Report and, if applicable, the SSP–MOE Data Report, each State must:

(1) Establish and employ procedures for determining whether its work activities may count for participation rate purposes;

(2) Establish and employ procedures for determining how to count and verify reported hours of work;

(3) Establish and employ procedures for identifying who is a work-eligible individual;

(4) Establish and employ internal controls to ensure compliance with the procedures; and

(5) Submit to the Secretary for approval the State's Work Verification Plan in accordance with paragraph (b) of this section.

(b) A State's Work Verification Plan must include the following:

(1) For each countable work activity:

(i) A description demonstrating how the activity meets the relevant definition at § 261.2;

(ii) A description of how the State determines the number of countable hours of participation for self-employed individuals; and

(iii) A description of the documentation it uses to monitor participation and ensure that the actual hours of participation are reported;

(2) A description of the State's procedures for identifying all work-eligible individuals, as defined at § 261.2;

(3) A description of how the State ensures that, for each work-eligible individual, it:

(i) Accurately inputs data into the State's automated data processing system;

(ii) Properly tracks the hours though the automated data processing system; and

(iii) Accurately reports the hours to the Department;

(4) A description of the procedures for ensuring it does not transmit to the Department a work-eligible individual's hours of participation in an activity that does not meet a Federal definition of a countable work activity; and

(5) A description of the internal controls that the State has implemented to ensure a consistent measurement of the work participation rates, including the quality assurance processes and sampling specifications it uses to monitor adherence to the established work verification procedures by State staff, local staff, and contractors.

(c) We will review a State's Work Verification Plan for completeness and approve it if we believe that it will result in accurate reporting of work participation information.

§ 261.63 When is a State's Work Verification Plan Due?

(a) Each State must submit its interim Work Verification Plan for validating work activities reported in the TANF Data Report and, if applicable, the SSP–MOE Data Report no later than September 30, 2006.

(b) If HHS requires changes, a State must submit them within 60 days of receipt of our notice and include all necessary changes as part of a final approved Work Verification Plan no later than September 30, 2007.

(c) If a State modifies its verification procedures for TANF or SSP–MOE work activities or its internal controls for ensuring a consistent measurement of the work participation rate, the State must submit for approval an amended verification plan by the end of the quarter in which the State modifies the procedures or internal controls.

§ 261.64 How will we determine if the State is meeting the requirement to establish and maintain work verification procedures that ensure an accurate measurement of work participation?

(a) We will determine that a State has met the requirement to establish work verification procedures if it submits an interim Work Verification Plan by September 30, 2006 and a complete Work Verification Plan that we approve by September 30, 2007.

(b) A ''complete'' Work Verification Plan means that:

(1) The plan includes all the information required by § 261.62(b); and

(2) The State certifies that the plan includes all the information required by § 261.62(b) and that it accurately reflect the procedures under which the State is operating.

(c) For conduct occurring after October 1, 2007, we will use the single audit under OMB Circular A–133 in conjunction with other reviews, audits, and data sources, as appropriate, to assess the accuracy of the data filed by States for use in calculating the work participation rates.

§ 261.65 Under what circumstances will we impose a work verification penalty for failure to submit a work verification plan or for failure to maintain adequate procedures to ensure a consistent measurement of the work participation rate?

(a) We will take action to impose a penalty under § 262.1(a)(15) of this chapter if:

(1) The requirements under §§ 261.64(a) and (b) have not been met; or

(2) We determine that the State has not maintained adequate documentation, verification, or internal control procedures to ensure the accuracy of the data used in calculating the work participation rates.

(b) If a State fails to submit an interim or complete Work Verification Plan by the due dates in § 261.64(a), we will reduce the SFAG payable for the immediately succeeding fiscal year by five percent of the adjusted SFAG.

(c) If a State fails to maintain adequate internal controls to ensure a consistent measurement of work participation, we will reduce the adjusted SFAG by the following percentages for a fiscal year:

(1) One percent for the first year;

(2) Two percent for the second year;

(3) Three percent for the third year;

(4) Four percent for the fourth year; and

(5) Five percent for the fifth and subsequent years.

(d) If a State complies with the requirements in this subpart for two consecutive years, then any penalty imposed for subsequent failures will begin anew, as described in paragraph (c) of this section.

(e) If we take action to impose a penalty under §§ 261.64(b) or (c), we will reduce the SFAG payable for the immediately succeeding fiscal year.

PART 262—ACCOUNTABILITY PROVISIONS—GENERAL

■ 1. The authority citation for part 262 is revised to read as follows:

Authority: 31 U.S.C. 7501 *et seq.*; 42 U.S.C. 606, 609, and 610; Pub. L. 109–171.

■ 2. In § 262.1, revise paragraphs (a)(13) and paragraph (a)(14), add paragraph (a)(15), and revise paragraph (c) to read as follows:

§ 262.1 What penalties apply to States?

(a) * * *

(13) A penalty equal to the amount of the State's Welfare-to-Work formula grant for failure to meet its basic MOE requirement during a year in which it receives the formula grant;

(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; and

(15) A penalty of not less than one percent and not more than five percent of the adjusted SFAG for failure to establish or comply with work participation verification procedures.

* * * * *

(c)(1) We will take the penalties specified in paragraphs (a)(1), (a)(2), and (a)(7) of this section by reducing the SFAG payable for the quarter that immediately follows our final decision.

(2) We will take the penalties specified in paragraphs (a)(3), (a)(4), (a)(5), (a)(6), (a)(8), (a)(9), (a)(10), (a)(11), (a)(12), (a)(13), (a)(14), and (a)(15) of this section by reducing the SFAG payable for the fiscal year that immediately follows our final decision.

* * * * *

■ 3. Amend § 262.2 by adding a new paragraph (d) as follows:

§ 262.2 When do the TANF penalty provisions apply?

* * * * *

(d) The penalty specified in § 262.1(a)(15) takes effect on October 1,

2006, for failure to establish work participation verification procedures and on October 1, 2007, for failure to comply with those procedures.

■ 4. Amend § 262.3 by revising paragraph (a)(1) to read as follows:

§ 262.3 How will we determine if a State is subject to a penalty?

(a)(1) We will use the single audit under OMB Circular A–133, in conjunction with other reviews, audits, and data sources, as appropriate, to determine if a State is subject to a penalty for misusing Federal TANF funds (§ 263.10 of this chapter), intentionally misusing Federal TANF funds (§ 263.12 of this chapter), failing to participate in IEVS (§ 264.10 of this chapter), failing to comply with paternity establishment and child support requirements (§ 264.31 of this chapter), failing to maintain assistance to an adult single custodial parent who cannot obtain child care for a child under 6 (§ 261.57 of this chapter), failing to reduce assistance to a recipient who refuses without good cause to work (§ 261.54 of this chapter), and after October 1, 2007 failing to comply with work participation verification procedures (§ 261.64 of this chapter).

* * * * *

■ 5. Amend § 262.6 by revising paragraphs (e) and (f) to read as follows:

§ 262.6 What happens if a State does not demonstrate reasonable cause?

* * * * *

(e) The corrective compliance plan must correct or discontinue the violation within the following time frames:

(1) For a penalty under §§ 262.1(a)(4), (a)(9), or (a)(15), by the end of the first fiscal year ending at least six months after our receipt of the corrective compliance plan; and

(2) For the remaining penalties, by a date the State proposes that reflects the minimum period necessary to achieve compliance.

(f) During the 60-day period following our receipt of the State's corrective compliance plan, we may request additional information and consult with the State on modifications to the plan including in the case of a penalty under § 262.1(a)(15), modifications to the State's work verification procedures and Work Verification Plan.

* * * * *

PART 263—EXPENDITURES OF STATE AND FEDERAL TANF FUNDS

■ 1. The authority section for Part 263 is revised to read as follows:

Authority: 42 U.S.C. 604, 607, 609, and 862a; Pub. L. 109–171.

■ 2. Revise § 263.2 to read as follows:

§ 263.2 What kinds of State expenditures count toward meeting a State's basic MOE expenditure requirement?

(a) Expenditures of State funds in TANF or separate State programs may count if they are made for the following types of benefits or services:

(1) Cash assistance, including the State's share of the assigned child support collection that is distributed to the family, and disregarded in determining eligibility for, and amount of the TANF assistance payment;

(2) Child care assistance (see § 263.3);

(3) Education activities designed to increase self-sufficiency, job training, and work (see § 263.4);

(4) Any other use of funds allowable under section 404(a)(1) of the Act including:

(i) Nonmedical treatment services for alcohol and drug abuse and some medical treatment services (provided that the State has not commingled its MOE funds with Federal TANF funds to pay for the services), if consistent with the goals at § 260.20 of this chapter; and

(ii) Pro-family activities that are consistent with the goals at §§ 260.20(c) or (d) of this chapter, but do not constitute ''assistance'' as defined in § 260.31(a) of this chapter; and

(5)(i) Administrative costs for activities listed in paragraphs (a)(1) through (a)(4) of this section, not to exceed 15 percent of the total amount of countable expenditures for the fiscal year.

(ii) Costs for information technology and computerization needed for tracking or monitoring required by or under part IV-A of the Act do not count towards the limit in paragraph (5)(i) of this section, even if they fall within the definition of ''administrative costs.''

(A) This exclusion covers the costs for salaries and benefits of staff who develop, maintain, support, or operate the portions of information technology or computer systems used for tracking and monitoring.

(B) It also covers the costs of contracts for the development, maintenance, support, or operation of those portions of information technology or computer systems used for tracking or monitoring.

(b) With the exception of paragraph (a)(4)(ii) of this section, the benefits or services listed under paragraph (a) of this section count only if they have been provided to or on behalf of eligible families. An ''eligible family'' as defined by the State, must:

(1) Be comprised of citizens or aliens who:

(i) Are eligible for TANF assistance;

(ii) Would be eligible for TANF assistance, but for the time limit on the receipt of federally funded assistance; or

(iii) Are lawfully present in the United States and would be eligible for assistance, but for the application of title IV of PRWORA;

(2) Include a child living with a custodial parent or other adult caretaker relative (or consist of a pregnant individual); and

(3) Be financially eligible according to the appropriate income and resource (when applicable) standards established by the State and contained in its TANF plan.

(c) Benefits or services listed under paragraph (a) of this section provided to a family that meets the criteria under paragraphs (b)(1) through (b)(3) of this section, but who became ineligible solely due to the time limitation given under § 264.1 of this chapter, may also count.

(d) Expenditures for the benefits or services listed under paragraph (a) of this section count whether or not the benefit or service meets the definition of assistance under § 260.31 of this chapter. Further, families that meet the criteria in paragraphs (b)(2) and (b)(3) of this section are considered to be eligible for TANF assistance for the purposes of paragraph (b)(1)(i) of this section.

(e) Expenditures for benefits or services listed under paragraph (a) of this section may include allowable costs borne by others in the State (e.g. local government), including cash donations from non-Federal third parties (e.g., a non-profit organization) and the value of third party in-kind contributions if:

(1) The expenditure is verifiable and meets all applicable requirements in 45 CFR 92.3 and 92.24;

(2) There is an agreement between the State and the other party allowing the State to count the expenditure toward its MOE requirement; and

(3) The State counts a cash donation only when it is actually spent.

(f)(1) The expenditures for benefits or services in State-funded programs listed under paragraph (a) of this section count only if they also meet the requirements of § 263.5.

(2) Expenditures that fall within the prohibitions in § 263.6 do not count.

(g) State funds used to meet the Healthy Marriage Promotion and Responsible Fatherhood Grant match requirement may count to meet the MOE requirement in § 263.1, provided the expenditure also meets all the other MOE requirements in this subpart.

■ 3. Revise § 263.6 to read as follows:

§ 263.6 What kinds of expenditures do not count?

The following kinds of expenditures do not count:

(a) Expenditures of funds that originated with the Federal government;

(b) State expenditures under the Medicaid program under title XIX of the Act;

(c) Expenditures that a State makes as a condition of receiving Federal funds under another program that is not in Part IV-A of the Act, except as provided in § 263.3;

(d) Expenditures that a State made in a prior fiscal year;

(e) Expenditures that a State uses to match Federal Welfare-to-Work funds provided under section 403(a)(5) of the Act; and

(f) Expenditures that a State makes in the TANF program to replace the reductions in the SFAG as a result of penalties, pursuant to § 264.50 of this chapter.

PART 265—DATA COLLECTION AND REPORTING REQUIREMENTS

■ 1. The authority citation for part 265 is revised to read as follows:

Authority: 42 U.S.C. 603, 605, 607, 609, 611, and 613; Pub. L. 109–171.

■ 2. Amend § 265.1 by revising paragraph (c) to read as follows:

§ 265.1 What does this part cover?

* * * * *

(c) If a State claims MOE expenditures under a separate State program(s), this part describes the case record information (disaggregated and aggregated) on individuals and families in the quarterly SSP–MOE Data Report that each State must file.

* * * * *

■ 3. Revise § 265.2 to read as follows:

§ 265.2 What definitions apply to this part?

(a) Except as provided in paragraph (b) of this section, the general TANF definitions at §§ 260.30 through 260.33 and the definitions of a work-eligible individual and the work activities in § 261.2 of this chapter apply to this part.

(b) For data collection and reporting purposes only, family means:

(1) All individuals receiving assistance as part of a family under the State's TANF or separate State program (including noncustodial parents, where required under § 265.5(g)); and

(2) The following additional persons living in the household, if not included under paragraph (b)(1) of this section:

(i) Parent(s) or caretaker relative(s) of any minor child receiving assistance;

(ii) Minor siblings of any child receiving assistance; and

(iii) Any person whose income or resources would be counted in determining the family's eligibility for or amount of assistance.

■ 4. Revise § 265.3 to read as follows:

§ 265.3 What reports must the State file on a quarterly basis?

(a) *Quarterly reports.* (1) Each State must collect on a monthly basis, and file on a quarterly basis, the data specified in the TANF Data Report and the TANF Financial Report (or, as applicable, the Territorial Financial Report).

(2) Each State that claims MOE expenditures for a separate State program(s) must collect on a monthly basis, and file on a quarterly basis, the data specified in the SSP–MOE Data Report.

(b) *TANF Data Report.* The TANF Data Report consists of four sections. Two sections contain disaggregated data elements and two sections contain aggregated data elements.

(1) *Disaggregated Data on Families Receiving TANF Assistance—Section one.* Each State must file disaggregated information on families receiving TANF assistance. This section specifies identifying and demographic data such as the individual's Social Security Number and information such as the amount of assistance received, educational level, employment status, work participation activities, citizenship status, and earned and unearned income. The data must be provided for both adults and children.

(2) *Disaggregated Data on Families No Longer Receiving TANF Assistance—Section two.* Each State must file disaggregated information on families no longer receiving TANF assistance. This section specifies the reasons for case closure and data similar to the data required in section one.

(3) *Aggregated Data—Section three.* Each State must file aggregated information on families receiving, applying for, and no longer receiving TANF assistance. This section of the TANF Data Report requires aggregate figures in such areas as: The number of applications received and their disposition; the number of recipient families, adult recipients, and child recipients; the number of births and out-of-wedlock births for families receiving TANF assistance; the number of noncustodial parents participating in work activities; and the number of closed cases.

(4) *Aggregated Caseload Data by Stratum—Section four.* Each State that opts to use a stratified sample to report the quarterly TANF disaggregated data must file the monthly caseload data by stratum for each month in the quarter.

(c) *The TANF Financial Report (or Territorial Financial Report).* (1) Each State must file quarterly expenditure data on the State's use of Federal TANF funds, State TANF expenditures, and State expenditures of MOE funds in separate State programs.

(2) If a State is expending Federal TANF funds received in prior fiscal years, it must file a separate quarterly TANF Financial Report (or, as applicable, Territorial Financial Report) for each fiscal year that provides information on the expenditures of that year's TANF funds.

(3) Territories must report their expenditure and other fiscal data on the Territorial Financial Report, as provided at § 264.85 of this chapter, in lieu of the TANF Financial Report.

(d) *SSP–MOE Data Report.* The SSP–MOE Data Report consists of four sections. Two sections contain disaggregated data elements and two sections contain aggregated data elements.

(1) *Disaggregated Data on Families Receiving SSP–MOE Assistance—Section one.* Each State that claims MOE expenditures for a separate State program(s) must file disaggregated information on families receiving SSP–MOE assistance. This section specifies identifying and demographic data such as the individual's Social Security Number, the amount of assistance received, educational level, employment status, work participation activities, citizenship status, and earned and unearned income. The data must be provided for both adults and children.

(2) *Disaggregated Data on Families No Longer Receiving SSP–MOE Assistance—Section two.* Each State that claims MOE expenditures for a separate State program(s) must file disaggregated information on families no longer receiving SSP–MOE assistance. This section specifies the reasons for case closure and data similar to the data required in section one.

(3) *Aggregated Data—Section three.* Each State that claims MOE expenditures for a separate State program(s) must file aggregated information on families receiving and no longer receiving SSP–MOE assistance. This section of the SSP–MOE Data Report requires aggregate figures in such areas as: The number of recipient families, adult recipients, and child recipients; the total amount of assistance for families receiving SSP–MOE assistance; the number of non-custodial parents participating in work activities; and the number of closed cases.

(4) *Aggregated Caseload Data by Stratum—Section four.* Each State that

claims MOE expenditures for a separate State program(s) and that opts to use a stratified sample to report the SSP–MOE quarterly disaggregated data must file the monthly caseload by stratum for each month in the quarter.

(e) *Optional data elements.* A State has the option not to report on some data elements for some individuals in the TANF Data Report and the SSP–MOE Data Report, as specified in the instructions to these reports.

(f) *Non-custodial parents.* A State must report information on a non-custodial parent (as defined in § 260.30 of this chapter) if the non-custodial parent:

(1) Is receiving assistance as defined in § 260.31 of this chapter;

(2) Is participating in work activities as defined in section 407(d) of the Act; or

(3) Has been designated by the State as a member of a family receiving assistance.

■ 5. Revise § 265.4 to read as follows:

§ 265.4 When are quarterly reports due?

(a) Each State must file the TANF Data Report and the TANF Financial Report (or, as applicable, the Territorial Financial Report) within 45 days following the end of the quarter or be subject to a penalty.

(b) Each State that claims MOE expenditures for a separate State program(s) must file the SSP–MOE Data Report within 45 days following the end of the quarter or be subject to a penalty.

(c) A State that fails to submit the reports within 45 days will be subject to a penalty unless the State files complete and accurate reports before the end of the fiscal quarter that immediately succeeds the quarter for which the reports were required to be submitted.

■ 6. Revise § 265.8 to read as follows:

§ 265.8 Under what circumstances will we take action to impose a reporting penalty for failure to submit quarterly and annual reports?

(a) We will take action to impose a reporting penalty under § 262.1(a)(3) of this chapter if:

(1) A State fails to file the quarterly TANF Data Report, the quarterly TANF Financial Report (or, as applicable, the Territorial Financial Report), or the quarterly SSP–MOE Data Report (if applicable) within 45 days of the end of the quarter;

(2) The disaggregated data in the TANF Data Report or the SSP–MOE Data Report are not accurate or a report does not include all the data required by section 411(a) of the Act (other than section 411(a)(1)(A)(xii) of the Act) or the nine additional elements necessary to carry out the data collection system requirements, including the social security number;

(3) The aggregated data elements in the TANF Data Report or the SSP–MOE Data Report required by section 411(a) of the Act are not accurate and the report does not include the data elements necessary to carry out the data collection system requirements and to verify and validate the disaggregated data;

(4) The TANF Financial Report (or, as applicable, the Territorial Financial Report) does not contain complete and accurate information on total expenditures and expenditures on administrative costs and transitional services; or

(5) The annual report under § 265.9 does not contain the description of transitional services provided by a State to families no longer receiving assistance due to employment.

(b) If we determine that a State meets one or more of the conditions set forth in paragraph (a) of this section, we will notify the State that we intend to reduce the SFAG payable for the immediately succeeding fiscal year.

(c) We will not impose the penalty at § 262.1(a)(3) of this chapter if the State files the complete and accurate quarterly report or the annual report before the end of the fiscal quarter that immediately succeeds the fiscal quarter for which the reports were required.

(d) If the State does not file all reports as provided under paragraph (a) of this section by the end of the immediately succeeding fiscal quarter, the penalty provisions of §§ 262.4 through 262.6 of this chapter will apply.

(e) Subject to paragraphs (a) through (c) of this section and §§ 262.4 through 262.6 of this chapter, for each quarter for which a State fails to meet the reporting requirements, we will reduce the SFAG payable by an amount equal to four percent of the adjusted SFAG (or a lesser amount if the State achieves substantial compliance under a corrective compliance plan).

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