other excepted qualified aliens consist of veterans, members of the military on active duty, and their spouses and unmarried dependent children, as well as permanent residents who have earned forty qualifying quarters. Like Federal TANF benefits, these groups are eligible to receive State public benefits under TANF without the time limit described above.

In light of sections 411 and 412 of PRWORA, we have concluded that, if a State uses segregated State TANF funds or separate State program funds to provide State or local public benefits, it may only claim for MOE purposes the qualified expenditures made with respect to eligible family members who are qualified aliens, nonimmigrants under the Immigration and Nationality Act, aliens paroled into this country under section 212(d)(5) of such Act for less than one year, and illegal aliens if the State enacted a law after August 22, 1996, that affirmatively provides for eligibility to receive specifically authorized State or local public benefits.

A State may claim the expenditures for illegal aliens for MOE purposes only if the law in question is broad enough to encompass TANF eligibility. The only avenue for claiming expenditures for illegal aliens in the definition of eligible families in section 409(a)(7)(B)(i)(IV) is under the criteria of families eligible for assistance under TANF. Once a State affirms that illegal aliens are eligible for TANF assistance, then the State may provide a State or local public benefit as part of TANF or a separate State program. For example, if the State's law only authorizes for child care to be provided to illegal aliens through a non-TANF program (e.g., CCDF), it could not claim any such expenditures as MOE. However, if its law authorizes child care provided through TANF for illegal immigrants, it may claim such expenditures as MOE. Or, if it provides such a service to illegal aliens through a separate State program and not the TANF program, but the illegal aliens are eligible for both, it may claim those expenditures as MOE.

A State may claim qualified expenditures for the individuals described in the prior two paragraphs for MOE purposes because these are the aliens who are either eligible for TANF benefits or lawfully present in this country and eligible for TANF assistance, but for the application of title IV of PRWORA. If a State decides to restrict alien eligibility for State public benefits, then it may only claim MOE for qualified segregated TANF expenditures or qualified separate State program expenditures made with respect to the excepted qualified aliens mentioned in section 412.

Two limited circumstances exist in which it may be possible for a State to help all aliens. These circumstances apply regardless of funding source, i.e., whether a State uses Federal TANF, State TANF, or separate State program funds. These circumstances derive from section 401(b) and (c) and section 411(b) and (c) of PRWORA, which describe alien eligibility for Federal public benefits and State or local public benefits, respectively.

First, both sections 401(b) and 411(b) of PRWORA affirm that States may provide certain noncash Federal or State and local public benefits to any alien. Such benefits are those necessary for the protection of life or safety and include those specified by the Attorney General in a notice dated August 23, 1996 (AG Order No. 2049–96, 61 FR 45985 available on line at http://www.acf.dhhs.gov/news/welfare/wr/830fdreg.htm). In the notice, the Attorney General specified the kinds of noncash government-funded community programs, services, or assistance that are necessary for protection of life or safety and for which all aliens continue to be eligible. However, for all aliens to be eligible, sections 401(b)(1)(D) and 411(b)(4) both state that neither the government-funded programs, services, or assistance provided, nor the cost of such assistance, may be conditioned on the individual recipient's income or resources. While such service may meet one of the purposes of TANF and may be provided as part of TANF or a separate State program, a State may claim toward MOE only qualified expenditures with respect to eligible (needy) families. Therefore, to claim any expenditures that meet the Attorney General's specifications for life and safety, a State must have a sound methodology that enables it to identify and claim only the portion of total qualified expenditures for benefits that it has provided to eligible families.

Second, section 401(c) defines a Federal public benefit and section 411(c) defines a State or local public benefit. Both sections use the same definition. The August 4, 1998, **Federal Register** notice that identified TANF as a Federal public benefit expressly states that not ''all benefits or services provided by these programs are 'Federal public benefits' and require verification.'' Because sections 401(c) and 411(c) use the same wording to define a public benefit, we believe this statement may also apply to benefits provided with segregated State TANF funds and separate State program funds. When a benefit is not a Federal or State or local public benefit, a State is not statutorily bound to restrict eligibility to certain aliens and can provide that benefit to all aliens.

The August 4, 1998 **Federal Register** ''Notice with Comment Period'' includes some general discussion about discerning whether a benefit should or should not be considered a Federal public benefit. We suggest this same discussion may be valuable to States in interpreting, per section 411(c), the specific services that a State would or would not consider a State or local public benefit under TANF or through a separate State or local program. If a particular benefit or service under the State's TANF program or separate State or local program is not a public benefit, then the State may claim qualified expenditures with respect to any alien family member who is ''eligible for TANF assistance.''

In addition we proposed that States may be able to count as MOE expenditures, funds transferred to Tribal grantees to assist families eligible under an approved Tribal TANF plan. However, if the eligibility criteria under the Tribal TANF program are broader than under the State's TANF plan, then all expenditures of State funds within the Tribal TANF program might not count as MOE. Only expenditures used to assist an ''eligible family'' under the State program count. States must ensure that State funds are expended on behalf of families eligible under the State's income and resource standards.

(c) Types of Activities

Section 409(a)(7)(B)(i)(I)(aa)–(ee) specifies that State expenditures on eligible families for the following types of assistance are ''qualified expenditures'' for basic MOE purposes:

- Cash assistance (see subsequent discussion on this);
- Child care assistance (see the discussion at § 263.3);
- Education activities designed to increase self-sufficiency, job training, and work (note the specific exception at § 263.4);
- Any other use of funds allowable under section 404(a)(1) (see subsequent discussion on this); and
- Associated administrative costs (subject to a 15-percent cap, as discussed in § 263.0 and subsequently).

It is important to remember that the activities mentioned above count toward a State's basic MOE requirement if they are reasonably calculated to accomplish a purpose of the program. This restriction follows from the language at section 409(a)(7)(B)(I)(ee) of the Act authorizing as MOE, ''any other

use of funds allowable under section 404(a)(1).'' Section 404(a)(1) of the Act refers to activities that are reasonably calculated to meet a purpose of the TANF program. The use of the word ''other'' infers that the activities listed above (ee), i.e., (aa)–(dd) must also be reasonably calculated to accomplish a purpose of the program. Hence, not only must expenditures of funds pursuant to (ee) be reasonably calculated to accomplish a TANF purpose, so must State expenditures pursuant to (aa)–(dd): cash assistance, child care assistance, educational activities, and administrative costs (discussed in detail further on).

We mentioned in the NPRM that expenditures for ''assistance'' for MOE purposes may take the form of cash, certificates, vouchers, or other forms of disbursement, as determined by the State. MOE expenditures may also be for ongoing, short-term, or nonrecurrent benefits. The definition of assistance at § 260.31 (§ 270.30 of the NPRM) does not limit the nature of State-funded aid provided to eligible families under TANF or separate State programs that can count as MOE. The authorization as MOE of ''any other use of funds allowable under section 404(a)(1)'' indicates that Congress intended all types of benefits provided to families under TANF under section 404(a)(1) of the Act should count as MOE. These can include ''nonassistance'' benefits such as nonrecurrent, short-term benefits.

Thus, State expenditures with respect to eligible families for activities such as pre-pregnancy family planning services, teen parenting programs, youth and family counseling or support services, job training or employment services, or forms of crisis assistance that meet the purposes of the program under section 404(a)(1) may also count toward meeting a State's MOE requirement. However, such expenditures are subject to other limitations and restrictions under §§ 263.5 and 263.6 (§§ 273.5 and 273.6 of the NPRM).

In the NPRM, we also addressed additional limitations and restrictions. We included some specific case situations that came to our attention and invited comment on these and other examples of aid for eligible families that States believed could qualify.

(1) Cash Assistance

This category includes cash payments, including electronic benefit transfers, to meet basic needs; assistance with work-related transportation costs; clothing allowances; and any child support collected on behalf of an eligible child that the State passes through to the eligible family.

The preamble in the proposed rule pointed out that section 5506(b) of Pub. L. 105–33 amended section 409(a)(7)(B)(i)(I)(aa) of the Act to specifically allow assigned child support collected by the State and distributed to the family to count toward a State's basic MOE so long as the amount is disregarded in determining the family's eligibility for and amount of TANF assistance. However, we neglected to point out that section 5506(b) also provided that the assigned child support distributed to the family must come from the State's share of the amount collected. The law specifically refers to the amount collected and distributed to the family under section 457(a)(1)(B). Section 457(a)(1)(B) provides that the State may retain or distribute to the family its share of the support amount so collected. Thus, more accurately, section 409(a)(7)(B)(i)(I)(aa) expressly allows the State's share of assigned child support amount collected on behalf of the family and distributed to the family to count toward a State's basic MOE, provided that the State disregards the amount sent to the family in determining the family's eligibility and amount of TANF assistance. We have clarified this point in the final rule.

Cash assistance also includes State expenditures on behalf of eligible families as part of a State's refundable Earned Income Tax Credit (EITC) program. Under a State EITC program, we determined that only expenditures, i.e., the refundable portion of EITC payments actually paid to eligible families, may count as MOE. Also, if the State had an EITC program in FY 1995, it may count the total amount of the refundable portion of the EITC actually paid to eligible families only to the extent that this amount exceeds the total amount of the refundable portion of the EITC actually paid in FY 1995 (see § 263.5).

(2) Any Other Use of Funds Allowable Under Section 404(a)(1)

Section 404(a)(1) provides that TANF funds may be used ''in any manner that is reasonably calculated to accomplish the purpose of the TANF program, including to provide low income households with assistance in meeting home heating and cooling costs.'' In § 260.20 (§ 270.20 of the NPRM), we list the statutory purposes of the TANF program.

(3) Medical and Substance Abuse Services

The statute does not prohibit the expenditure of State MOE funds on medical expenditures. Therefore, States may count expenditures of their own funds to provide treatment services to individuals seeking to overcome drug and/or alcohol abuse when these services assist in accomplishing the purposes of the program. This policy would also comport with both the Administration's support for drug rehabilitation services and the congressional call for State flexibility in the operation of welfare programs.

We reminded States that such expenditures must be consistent with the purposes of the program and made to, or on behalf of, eligible families. We also reminded States that section 408(a)(6) bars the use of Federal TANF funds for medical services. Therefore, States using MOE funds to provide medical treatment services may not commingle State and Federal TANF funds. In addition, any State expenditures on medical services that are used to obtain Federal matching funds under the Medicaid program would not count as MOE. (Refer to the discussion under § 263.6.) Finally, State expenditures on medical and substance abuse services may only count as MOE subject to the ''new spending'' limitations set forth in § 263.5.

(4) Juvenile Justice

State funds used to pay the costs of benefits or services provided to children in the juvenile justice system and previously matched under the EA program do not count toward MOE. More specifically, as juvenile justice services do not meet any of the purposes of the TANF program, they are not an allowable use of funds under section 404(a)(1).

While some States may expend their Federal TANF funds for this purpose, under section 404(a)(2), the definition of ''qualified State expenditures,'' for MOE purposes, does not include the reference to section 404(a)(2). Therefore, we have concluded that Congress did not intend to automatically qualify all previously authorized IV–A expenditures as MOE. States that expend Federal TANF funds for this purpose, under section 404(a)(2), must not commingle State funds with Federal TANF funds if they wish the State funds to count as MOE.

(5) State ''Rainy Day'' Funds

Some States inquired whether State funds allocated or set aside during a fiscal year as a ''rainy day'' fund, to act as a hedge against any economic downturn, could count as MOE. While we understand State intent, these allocations or set-asides are not expenditures. States must actually expend funds on behalf of eligible

families during the fiscal year for the money to count toward the State's MOE for that fiscal year. (However, under section 404(e), States may reserve Federal TANF funds from any fiscal year for use in any other fiscal year.)

(6) Administrative Costs

Administrative expenditures may count toward a State's MOE, but only to the extent that they do not exceed 15 percent of the total amount of qualified State expenditures for the fiscal year. This limitation is the same as the limit for Federal TANF administrative expenditures. Therefore, we proposed that the State apply the same definition of administrative costs for MOE purposes as for Federal TANF funds.

Section 404(b)(2) states that expenditures of Federal TANF funds with respect to information technology and computerization needed for tracking or monitoring activities are not subject to the 15-percent TANF limit. We are providing the same flexibility with respect to the administrative cost cap on MOE expenditures. Thus, the rules do not include information technology and computerization expenditures under the administrative cost cap; they allow such expenditures to count toward meeting a State's MOE requirement, without being limited by the 15-percent cap on administrative expenditures.

Comments and Responses

Summary

We received numerous comments on § 273.2 of the proposed rule. Many of the comments focused on the definition of eligible family. One commenter praised our broad interpretation of the term ''eligible family.'' Others indicated that it may not be broad enough. Numerous commenters requested clarification of the definition.

We also received comments regarding some of the examples of qualified expenditures mentioned in the proposed rule as well as a few comments on other examples of aid for eligible families that commenters believe could qualify. Although we received only a few specific comments regarding the 15-percent cap on administrative MOE expenditures, we received a substantial number of comments on various aspects of the proposed definition of administrative costs. Since this definition applies to the State as well as the Federal cap on administrative expenditures, we refer you to the beginning of this subpart, at § 263.0, for a fuller discussion of the various issues raised and conclusions reached regarding the final definition of administrative costs.

Finally, a couple of the comments concerned the cash management principles governing the draw-down of Federal TANF funds because the draw-down of Federal TANF funds is tied to MOE expenditures.

After carefully considering the comments, we made some clarifications and a few changes to the final rule. We will address the comments following the order of the NPRM preamble.

(a) Qualified State Expenditures

Comment: One commenter noted that States have raised a number of questions regarding application of the Cash Management Improvement Act (CMIA) to the TANF program and MOE funds. The commenter recommended incorporating the guidance currently being developed jointly by the Financial Management Service (FMS) of the U.S. Department of Treasury and ACF in the final rule, as appropriate.

Another commenter recommended clarifying the final rule to specify that States may draw down Federal TANF funds without being required to show that they met their MOE requirement by the end of the year. The commenter wrote that our rules impose a de facto match requirement that is burdensome on States and could cause cash flow problems.

Response: The guidance the commenter is referring to has not yet been completed. We intend to release it as a separate issuance once it is completed. In the meantime, CMIA Policy Statement Number 19, dated June 1, 1997, and issued by FMS provides general cash management guidelines for States in drawing down their Federal TANF funds.

Federal TANF funds are subject to the Cash Management Improvement Act and the grant regulations at 45 CFR 92.20(b)(7). These rules restrict the draw-down of Federal funds. The CMIA Policy Statement Number 19 requires that States must expend a proportionate share of MOE funds for any period the State draws down Federal TANF funds. Thus, we have not made the recommended clarification.

The MOE requirement is not a de facto match requirement. However, it is similar to a matching requirement in one respect. It is a cost-sharing requirement, as Congress recognized that State financial participation is essential for the success of welfare reform.

To allow a State to expend Federal TANF funds first, then later spend State funds to fulfill the basic MOE requirement, would convey to the State a benefit (interest income) that was not authorized by the legislation establishing TANF. PRWORA did not provide for the TANF block grant allocations plus interest. The recommended action would also be in violation of 31 U.S.C. 6503(c)(1), which governs intergovernmental financing and the U.S. Treasury-State (cash management) Agreements signed by each State and Territory.

Although States must meet their basic MOE level for a fiscal year by the end of that fiscal year, the guidance in CMIA Policy Statement Number 19 does not restrict a State's ability to draw down its full TANF grant. Once a State meets its basic MOE requirement, the State may draw down its remaining TANF funds without contributing additional MOE funds. However, the draw-down of Federal TANF funds must be for immediate cash needs. Under no circumstances may a State draw down funds that are not needed for a specific program expenditure.

(b) Eligible Families

In addition to comments as discussed below, we corrected an incomplete citation in § 273.2(c) of the NPRM. This paragraph addressed the circumstances under which expenditures on families that had exceeded the Federal time limit would count as MOE. It should have cited paragraphs (b)(1), (b)(2), and (b)(3)—thus indicating that the families receiving assistance had eligible alien status, included a child living with an adult relative, and were needy under the financial criteria in the TANF plan. However, it failed to include the reference for this third provision. In the final rule, we corrected this language.

Comment: A few commenters argued that we should leave the definition of ''eligible family'' to each State. One commenter said that the proposed definition attempts to usurp the State's authority to define eligible family; another indicated that Congress was silent on this topic.

Response: We do not agree that Congress was silent on the topic of ''eligible families.'' In fact, this issue is addressed in the Conference Report (H.R. Rep. No. 725. 104th Cong., 2d sess., at 56, p. 296). In pertinent part, the conferees agreed that ''qualified expenditures that count toward the * * * spending requirement are all State-funded expenditures under all State programs that provide any of the following assistance to families eligible for family assistance benefits (TANF). * * *'' More importantly, section 409(a)(7)(B)(i)(I) of Act provides that qualified expenditures count if made with respect to eligible families. Section

409(a)(7)(B)(iv) defines eligible families in pertinent part as ''families eligible for assistance under the State program funded under this part,'' i.e., under TANF.

Because we must enforce a penalty if a State fails to meet the basic MOE requirement, we must specify the standards for that penalty. The term ''eligible families'' is a critical part of those standards. In this way, States may know which expenditures may count and avert a penalty.

Comment: Several commenters expressed concern that the proposed rule does not allow expenditures to be counted toward the basic MOE requirement if made for lawfully residing aliens who are not included in the definition of ''qualified alien,'' such as certain persons residing under color of law (PRUCOL). The commenters pointed out that section 5506(d) of the Balanced Budget Act of 1997 (Pub. L. 105–33) amended the welfare reform law to allow States to count towards MOE funds spent on ''families of aliens lawfully present in the United States that would be eligible for such assistance but for the application of title IV.''

Response: We agree that the Balanced Budget Act made this change and mentioned it in the preamble to the NPRM. Also, the proposed regulation recognized that MOE expenditures could be used to help certain eligible nonqualified alien family members (nonimmigrants under the Immigration and Nationality Act and aliens paroled into the U.S. for less than one year). However, as previously mentioned, we did not accurately analyze the significance of this statutory language (defining ''eligible families'' for MOE claiming purposes relative to the extant provisions of title IV of PRWORA). Refer to the earlier extensive discussion regarding the noncitizens for whom the State may claim MOE expenditures.

Comment: Several commenters questioned the proposed rule at § 273.2(b)(2), which required that a child live with a custodial parent or other adult caretaker relative. One commenter noted that the Balanced Budget Act of 1997 eliminated the relationship requirement under 408(a)(1) of the Act. The commenters believed the statutory definition of eligible families under section 409(a)(7)(B)(i)(IV) and even the proposed rule permitted them to assist children who do not live with a custodial parent or other adult caretaker relative (e.g., children in foster care and juvenile justice situations). For example, expenditures associated with helping a child who lives in an alternative living arrangement had been permissible under the former Emergency Assistance program and therefore should count toward the basic MOE requirement. Another commenter believed the proposed rules were too narrow and recommended modifying the rules to permit qualified State expenditures for such children to count toward the basic MOE requirement.

Response: We do not agree that the Balanced Budget Act did away with the relationship requirement. We do not believe that Congress intended to eliminate the relationship requirement for either State MOE dollars or Federal TANF funds. Section 5505(a) of the Balanced Budget Act of 1997 expressly indicates that section 408(a)(1) was amended to eliminate redundant language. Previously, both sections 408(a)(10) (the home residence requirement) and 408(a)(1) (the minor child requirement) explicitly stated that Federal TANF funds could only be expended on a family that includes a child residing with a parent or other caretaker relative. The Balanced Budget Act removed the redundant phrase from 408(a)(1) and added a cross-reference to 408(a)(10), where the phrase remains intact.

Section 409(a)(7)(B)(i)(IV) defines eligible families, in pertinent part, as ''families eligible for assistance under the State program funded under this part.'' The State program funded under this part is the TANF program, whether funded with the Federal grant and/or State funds. The criteria with respect to TANF assistance include the provisions under section 408, and specifically the provision just discussed under 408(a)(1). Under section 408(a)(1), no family is eligible for TANF assistance unless the family includes a minor child who resides with the parent or other caretaker relative. Therefore, we believe there is a direct correlation between sections 408(a)(1) and 409(a)(7)(B)(i)(IV).

We conclude that the intent of section 409(a)(7)(B)(i)(IV) is that the family include a child residing with a parent or other caretaker relative. A State may still choose to aid the ''child-only'' cases that exclude the adult(s) from the case. Nevertheless, that child must be residing with a parent or other caretaker relative. Qualified State expenditures under all programs (TANF or separate State programs) may count toward basic MOE if made with respect to eligible families who meet the above criteria and are for one of the categories of activities listed under 409(a)(7)(B)(i)(I). As we indicated in the proposed rule, not all expenditures for services that had been previously authorized under the former AFDC, EA, or JOBS programs qualify for MOE purposes. In particular, there are services (e.g., juvenile justice situations) that do not meet any of the purposes of the TANF program. Rather, such former EA services generally fall under section 404(a)(2), not 404(a)(1). Therefore, the expenditures do not qualify.

Comment: A few commenters requested that we revise the language at § 273.2(b)(2) of the proposed rule to permit the provision of assistance to minors who are temporarily absent from the home, similar to the time periods given in section 408(a)(10)(A).

Response: As we explained above, an ''eligible family'' is defined, in part, as one in which there is a child residing with a parent or other caretaker relative. Thus, the child's home is that of the parent or other caretaker relative. However, as with TANF, under section 408(a)(10), we expected that States would establish policies that define a reasonable period of temporary absence of the minor from the home for MOE purposes. Otherwise, qualified expenditures to provide services or assistance to the child once he or she left the home would no longer count toward basic MOE.

During the temporary period, the child is considered to be residing with the parent or other caretaker relative. Therefore, State may continue to help the eligible family through expenditures that are reasonably calculated to accomplish a purpose of the program, including some expenditures for the temporarily absent child (except as noted later in this discussion). As we previously mentioned, all qualified expenditures must be reasonably calculated to accomplish a purpose of the program.

For example, family preservation services, such as parenting training or counseling, and some forms of transitional assistance, could help ensure that parents may care for their children in their own home (purpose 1). In contrast, it is unlikely that expenditures on child care services would be reasonably calculated to accomplish that purpose (or any of the other TANF purposes) if the only child in the eligible family is temporarily absent from the home.

Sometimes the child is temporarily absent from the home because he or she has been placed in the care of a correctional facility, juvenile residential facility, group home, protective care, foster care, other facility or other nonrelative care arrangement. Since the child is deemed to be residing with his or her parent or other caretaker relative during the temporary period, expenditures reasonably designed to

accomplish the purpose of the program, including continuation of cash assistance, would count toward MOE. However, expenditures for residential care as well as assessment or rehabilitative services, including services provided to children in the juvenile justice system, do not meet any of the purposes of the TANF program and would not count toward basic MOE. The principal purpose for placement is to protect the child or to protect society because of the child's behavior, not to care for the child in his or her own home (purpose 1). Since the focus is to address the child's needs, expenditures to care for the child in these living situations does not end the dependence of needy parents on government benefits by promoting job preparation, work and marriage (purpose 2). The remaining two purposes do not even remotely relate to this situation.

It is important to note that this interpretation does not preclude a State from providing foster care or other protective care assistance for the child. However, these expenditures do not count toward the State's basic MOE requirement because they are not reasonably calculated to accomplish a purpose of the program.

It would be reasonable for States to use the time frames given under section 408(a)(10) to define ''temporary'' and to develop a corresponding MOE policy. (Section 408(a)(10) automatically applies when a State uses commingled State funds to provide TANF assistance.) The child must return to the home by the end of the temporary period established by the State. Otherwise, the child no longer resides with the parent or other caretaker relative. If the child is the only eligible minor in the eligible family, then services or assistance for the eligible family would no longer count toward the basic MOE requirement, if the child does not return after the temporary absence.

We do not believe it is reasonable to determine that a child is temporarily absent from the home if the child has been adjudicated or otherwise determined to require placement out of the home for longer than the State's established temporary period. In these situations, the absence is for a significant period, and expenditures for the child do not count as qualified once the child has left the home. Further, the child is not deemed to be residing with his or her parent or other caretaker relative. If the child is the only child in the family, then qualified expenditures to provide services or assistance to the family would no longer count toward basic MOE once the child left the home.

Comment: The NPRM indicated that a State is free to define who is a member of a family for TANF and MOE purposes and can choose to assist other family members such as noncustodial parents. Several commenters requested clarification regarding the effect of including the noncustodial parent or others as a member of the eligible family (e.g., applicability of sanctions). The commenters asked whether ''assistance'' provided to a noncustodial parent counts against the family for purposes of the time limit; whether a State can provide assistance or services to a noncustodial parent without providing assistance to the rest of the family; and whether a State must include the noncustodial parent as a family member. One advocacy group also asked whether a State could provide assistance to other relatives not living in the home; define a family to include more distant relatives not in the home; or even include nonrelatives not living in the home. A community organization felt that the potential addition of noncustodial parents or others not historically included within the family should not be totally discretionary with the State. The commenter recommended regulatory restrictions such as not providing assistance to a noncustodial parent when the custodial parent is not assisted. Another community organization requested that we spell out the full ramifications of States providing assistance outside the traditional ''AFDC household'' so that States will be aware of the consequences of their decisions.

Response: A number of commenters appeared to have interpreted our statement that States could include the noncustodial parent as part of the family to mean that any persons outside of the home may be a member of the eligible family. However, we did not intend for other relatives or nonrelatives not living in the home to be included as members of the eligible family. Only if a child is eligible in the home in which such other individuals live may the State choose to include them as part of that eligible family.

At minimum, an eligible family must consist of a minor child who resides with a parent or other caretaker relative (or consist of a pregnant individual). Beyond this minimum configuration, States may add other household members to comprise the eligible family. Thus, we expected that a State would configure a family from the individuals living in the home.

The only exception to this rule is the noncustodial parent. As the child's parent, a State may choose to include the noncustodial parent as a member of the child's eligible family. It also may choose not to. Further, a State may choose the circumstances under which a noncustodial parent would be a member of the child's eligible family. We leave this to State discretion and have included a minimal definition of noncustodial parent at § 260.30.

However, it is important to remember that an adult may receive TANF assistance only as part of a TANF family. This means that an adult, including a noncustodial parent, cannot apply for or receive TANF assistance independent of the child and custodial parent or caretaker relative, if applicable. Once the State determines the family is eligible, it is up to the State to determine the most appropriate assistance and nonassistance benefits to provide to family members.

Similarly, expenditures for adults only count for basic MOE purposes if the adult is part of a TANF or TANF-eligible family (i.e., a family that would be eligible for TANF assistance, but whose family members are not necessarily receiving it). And, as with TANF, the State determines the appropriate benefits to provide the eligible family.

As a member of the child's eligible family, a State could provide a noncustodial parent with benefits or services that could further the family's ability to attain economic self-support and self-sufficiency. Congress clearly supported this notion. For example, in section 101 of PRWORA, Congress stated that promotion of responsible fatherhood and motherhood is integral to the well-being of children. In section 407(h) of the Act, Congress expressed support for requiring noncustodial, nonsupporting parents under the age of 18 to fulfill community work obligations and attend appropriate parenting or money management classes after school. A provision in section 466(a) of the Act permits a State to issue an order, or to request that a court issue an order, requiring an individual owing past-due child support to participate in work activities, as defined in section 407(d) of the Act.

In our NPRM discussion of individual regulatory provisions, we also suggested that States examine the various sections of this rule where the term family is used. We understood that States needed to realize the other effects, in terms of the TANF requirements, of adding other persons to the eligible family. Applicability of any or all the TANF requirements depends on whether a family member is receiving TANF ''assistance'' as defined in § 260.31.

Applicability of a TANF requirement also depends on the person(s)

mentioned in a particular requirement. The TANF requirements use various terms, such as ''adult or minor child head-of-household,'' ''adult,'' ''teen parent,'' ''family member,'' ''individual,'' ''parent or other caretaker relative,'' or ''single custodial parent'' when referring to family members. The effect of a requirement may vary depending on the status of the person(s) receiving assistance. Each requirement must be examined to determine the effect of the status of family members on its applicability or on the amount of assistance paid (e.g., in sanction cases).

For example, the calculation of the work participation rates under section 407(b) of the Act consists of the number of families receiving assistance under the State program funded under this part that include an adult or a minor child head-of-household who engaged in work for the month (the numerator), divided by the number of families receiving TANF assistance during the month that include an adult or a minor head-of-household minus the number of families that are subject to a penalty for refusing to work in that month—except if a family has been sanctioned for more three of the last 12 months (the denominator). For this requirement, once a TANF eligible family includes an adult who receives some form of TANF ''assistance,'' the family is included in the calculation of the work participation rate, and the adult may be required to participate in work activities. An ''adult'' eligible family member receiving TANF assistance could be the custodial parent or other adult caretaker relative, a noncustodial parent, or any other adult household member as determined by the State.

Furthermore, section 407(e) of the Act requires the State to reduce or terminate the family's TANF assistance if an individual in the family refuses to engage in required work. ''Individual'' eligible family members could include the noncustodial parent or other members of the eligible family. Yet, the child care exception applies only if the individual refusing is a single custodial parent caring for a child under age six.

Applicability of a requirement can also depend on the context of the funding. The term ''under the State program funded under this part'' used in the above provisions, as well as the terms ''under the program'' and ''under the program funded under this part,'' all mean the State's TANF program, whether funded with Federal or State funds. Applicability of a TANF provision also depends on whether the State funds under the TANF program to provide assistance to the family member are commingled with, or segregated from, Federal grant funds. We mentioned earlier in this discussion that a State could expend State funds for MOE purposes in different ways. In terms of the TANF program, State expenditures may be commingled with, or segregated from, Federal grant funds. Provisions in the statute that use any of the above-mentioned terms apply to Federal or State-funded (whether commingled or segregated) assistance received under the TANF program, as depicted in the above examples.

In addition, under section 408(a)(3) and title IV–D of the Act, a family may not receive TANF assistance unless an assignment of support rights has been executed on the child's behalf. The assignment would also include the right to spousal support in the case of a custodial parent who receives TANF assistance. However, as discussed in the preamble to § 260.31, if the noncustodial parent also receives TANF assistance as a family member, the assistance provided to the noncustodial parent will not be considered ''assistance'' for purposes of the collection and distribution of assigned child support under title IV–D of the Act.

Provisions that only use the term ''grant'' or ''amounts attributable to funds provided by the Federal government'' (e.g., the five-year time limit, and expenditures for medical services) refer only to assistance provided using Federal TANF funds. They do not apply to State-funded TANF assistance unless the assistance comes from commingled funds. If a family member receives assistance from commingled State funds, then rules that would otherwise only pertain to the use of Federal grant funds apply.

However, as discussed at § 264.1, after further analysis, we have interpreted the five-year limit to only apply when the adult family member is the head-of-household or the spouse of the head-of-household and receiving assistance. Thus, if the noncustodial parent (i.e., the parent living in another household) receives TANF assistance as an eligible family member, that receipt impacts the family's lifetime limit only if he or she is the spouse of the head-of-household. We believe this situation will occur rarely, if ever. The months that any other adult eligible family member who is not the head-of-household or the spouse of the head-of-household receives TANF assistance would not count toward the family's lifetime limit.

A State may also aid eligible family members by providing various services under the TANF program that do not constitute ''assistance.'' If so, the TANF requirements explained above do not apply. Services that are not assistance (e.g., counseling, job readiness, employment placement or post-employment services) may be provided to any eligible family member, e.g., the noncustodial parent.

For basic MOE purposes, expenditures must be with respect to an individual who is a member of an eligible family. An eligible family member may also receive ''nonassistance'' or ''assistance'' through a separate State program. The requirements applicable to ''assistance'' received under the TANF program do not apply to separate State programs or to ''nonassistance'' provided to members of an eligible family.

Comment: The definition of eligible families prohibits States from counting for MOE purposes expenditures made for pregnancy prevention services to childless individuals.

Response: Such expenditures would count toward meeting the basic MOE requirement only if the childless individual is a member of an eligible family, e.g., an eligible teen family member. Section 409(a)(7)(B)(i)(I) expressly provides that only qualified expenditures made with respect to members of eligible families count. Thus, we have not changed the final rule. However, Federal TANF funds may be used for this purpose to provide ''nonassistance'' per section 401(a)(3) of the Act.

Comment: Numerous commenters requested clarification of § 273.2(b)(3) of the NPRM which required that an eligible family must be financially eligible according to the TANF income and resource standards established by the State under its TANF plan. The commenters indicated that a uniform or single income/resource standard is inappropriate as it would restrict States' ability to provide families with services such as transitional assistance, e.g., child care, transportation, ongoing case management, education and training, or diversion services for families who need one-time or short-term help to prevent the need for traditional TANF cash assistance. A few commenters noted that a State's child care program may have its own income and resource limits. Another commenter indicated that the lack of flexibility may prevent certain transfers to tribal TANF programs from counting toward basic MOE. Therefore, commenters asked us to clarify the rules to allow for different standards of need for different types of services. They wanted a definition broad enough to cover families such as those who are transitioning off TANF, those who are at risk of receiving TANF, and those served through separate State

programs. Finally, another commenter asked us to de-link MOE and TANF eligibility.

Response: The proposed rule at § 273.2(b)(3) provided that an eligible family must be financially eligible according to the TANF income and resource standards established by the State under its TANF plan. It appears that commenters interpreted our use of the plural term, ''standards,'' to mean that the elements used to determine financial eligibility (income and resources) constituted a single set of criteria for all the services that a State would provide. This was not our intention. We used the term ''standards'' in the event a State wanted to have multiple financial requirements based on the different services that it wished to provide or the scope of families it wished to aid.

States have the flexibility to decide the particular income and resource requirements that they will use to determine whether a family is financially eligible to receive a service, a package of services, or all of the services provided with State basic MOE funds. Thus, both income and resource requirements may vary, as determined by the State. For example, a State could establish different financial criteria for families no longer receiving TANF cash assistance in order that family members may receive transitional services. Or, a State may want to establish standards for providing short-term or nonrecurrent assistance to families in order to prevent the need for ongoing TANF assistance.

Section 409(a)(7)(B)(IV) of the Act indicates that an eligible family is a family who is or would be eligible (as provided in this section) for assistance under the State program funded under this part. The State's TANF program is the State program funded under this part. Thus, there is a statutory link between MOE and the State's TANF program. However, that link merely requires that an eligible family is or would be eligible for TANF assistance. It does not require that eligible family members must necessarily receive TANF cash assistance or any other benefit or services through the TANF program. Section 407(a)(7)(B)(i)(I) of the Act permits the State to help eligible family members through activities in ''all programs,'' i.e., TANF and separate State programs.

Comment: Some commenters mentioned that States should be able to use basic MOE funds to create programs with definitions of need that may not assess income and assets at all. They argued that section 409(a)(7) allows a State to claim basic MOE spending with respect to eligible families for any use of funds that are reasonably calculated to accomplish the purpose of the TANF program. Providing assistance to needy families is mentioned in only two of the four purposes of the program under section 401(a) of the Act. Thus, the term ''eligible families'' should include a broader population of families, not just those who are needy families. Two commenters, including one national organization, also noted that the TANF purposes do not require that spending has to be made to, or on behalf of, an eligible family. For example, preventing and reducing the incidence of out-of-wedlock pregnancies and encouraging the formation and maintenance of two-parent families could involve the development of materials, pamphlets, videotapes, and counseling activities directed at teen pregnancy prevention and other pregnancy prevention initiatives. Such expenditures benefit all TANF eligible families but do not necessarily benefit any one family in particular.

Response: As we explained in the above response, the statute defines MOE expenditures as those made ''with respect to eligible families.'' Thus, it clearly links MOE expenditures to eligible families. An eligible family is a family who is or would be eligible for assistance under the State's TANF program. A family may not receive ''assistance'' under the State's TANF program unless the family is needy. We interpreted the term ''needy'' for TANF and MOE purposes to mean financial deprivation, i.e., lacking adequate income and resources. We continue to believe this is the most appropriate interpretation and decline to expand the scope of the definition of needy. Hence, for basic MOE purposes, eligible families are those who are financially eligible according to the State's applicable income and resource criteria.

States may establish different income and resource criteria to cover the scope of needy eligible families they wish to serve or the various services or activities they want to provide. States are free to design programs involving MOE activities, including those mentioned by the commenter, to reach as broad a population as they choose. However, only that part of the total expenditures made on behalf of eligible families who meet the State's applicable financial eligibility criteria counts toward a State's basic MOE.

We would like to point out that Federal TANF funds may also be used to pay for ''nonassistance'' activities (such as those described above) that meet the purposes of the program as given in section 401(a)(1)–(4) of the Act and § 260.20. Federal TANF funds may also be used for activities that benefit non-needy families in some cases, e.g., activities that meet the purpose of either section 401(a)(3) or (a)(4) of the Act. In this respect, there may be more flexibility in the expenditures that are allowable uses of Federal funds than those that are allowable for MOE purposes. This is because federally funded services or benefits do not necessitate a determination of financial eligibility (need) if they do not meet the definition of assistance. Thus, States may use Federal TANF funds (in accordance with section 404 of the Act) to provide ''nonassistance'' services or benefits to eligible individuals who meet the State's other, nonfinancial, objective criteria for the delivery of such benefits.

Comment: Some commenters asked whether a State must make use of resource standards, noting that there is no statutory requirement to do so. Other commenters noted that the definition of ''needy'' may or may not include an asset test. For various benefits, a State may just establish income criteria to determine the families who are eligible for the benefit. One national organization also indicated that some States are considering eliminating resource standards.

Response: Title IV–A of the Act setting forth the TANF program does not address income or resource requirements (except under section 408(f) with respect to deeming an alien's sponsor's income and resources). Rather, it uses the term ''needy.'' Although we interpreted ''needy'' to mean financial deprivation, i.e., lacking adequate income and resources, we also recognize that some State programs may just involve an income test. Therefore, we are not requiring States to have resource requirements. We have clarified this point in the final rule under § 263.2(b)(3) by stating that a family must be financially eligible according to the appropriate TANF income and resource (when applicable) requirements established by the State and contained in its TANF plan. (We discuss eligibility criteria in the TANF plan further in response to other comments in this section.) In this way, States not only decide the scope of families they want to serve, but also the families most in need of particular programs or services.

Comment: One commenter noted that, with respect to resources, a State's standard may address cash assets only. Two commenters indicated concern that an asset limit that does not allow a family to own a serviceable and reliable vehicle to get to work or services is

extremely counterproductive to moving people to work.

Response: It is the State's responsibility to specify income and/or resource limits. States define resources and determine which resources are considered, e.g., whether both liquid and nonliquid resources must be considered and the dollar limit(s) for each type of resource. For example, many States have already eased restrictions that prevented AFDC recipients from owning cars. Some States are increasing the excluded value or discounting entirely the value of a motor vehicle in determining TANF eligibility. We agree that such actions can promote job preparation and work.

Comment: A few commenters, including two advocacy groups, recommended that we establish a ceiling on the income standards used by a State to ensure that basic MOE expenditures are appropriately targeted to help families most in need.

Response: The proposed rules were silent on this issue. However, we do not think it is appropriate for us to establish a ceiling in the final rule. TANF leaves this responsibility to the States. We hope that States will establish reasonable income standards to ensure that expenditures are targeted to families most in need.

While Congress did not explicitly provide for an income cap under TANF, we believe that Congress was very interested in the ways States are targeting their resources to help families most in need find work and move toward self-sufficiency. For example, section 404(d)(3)(B) of the Act requires that TANF funds transferred to title XX programs must be used only for programs and services to children or their families whose income is less than 200 percent of the income official poverty line (as defined by the Office of Management and Budget) applicable to a family of the size involved. Thus, we re-emphasize our hope that States will target their resources in ways that help needy families and support the goals of the program.

In § 265.9(c), we discuss the required information on MOE programs that States must submit annually. For example, States must report the eligibility criteria for the families served under each MOE program/activity. This information will help us to know the scope of families served in the various MOE programs. At some future date, depending on how MOE programs evolve, we may want to look at addressing MOE-related issues through legislative or regulatory proposals.

Comment: Two commenters asked what the applicable standard is for purposes of basic MOE calculations if a State applies different income standards to different forms of assistance.

Response: For purposes of counting MOE expenditures, qualified expenditures under all State or local programs consist of expenditures claimed with respect to eligible families (or eligible family members) who met the financial criteria (income and resource requirements, when applicable) corresponding to the particular activity (i.e., service or assistance provided) as described in the State plan.

It is also important to note that the TANF compliance supplement issued by OMB for auditors will include the basic MOE requirement. In addition, States may be subject to other audits or reviews from time to time. Therefore, States must be able to support their MOE expenditures with adequate documentation.

Comment: One commenter recommended that we replace the term ''eligible families'' with ''TANF-related families'' to give States flexibility to help families become self-sufficient. Another commenter recommended that we define ''eligible families'' to include persons eligible for any benefit that could be made to a family with TANF funds in the State program, i.e., any expenditure that could be made under section 404(a)(1) or (2) of the Act with respect to a family. Thus, a State could use its own funds to pay for benefits that it would otherwise have paid with Federal TANF grant funds.

Response: ''Eligible families'' is the term used in the statute. Therefore, we believe this is the appropriate term to use in the rules. As we explained earlier, States are free to establish different income and resource (when applicable) criteria to match the scope of families it wishes to serve and type of services it wants to provide. In the TANF program and in separate State programs, States have the flexibility to offer a range of services that they think will help eligible families attain and maintain self-sufficiency. However, for basic MOE purposes, States cannot necessarily use their own funds in the same ways as Federal TANF funds. To count toward basic MOE, expenditures of State funds must be made with respect to eligible families. The expenditures, whether under or separate from the TANF program, must provide the family or family members with services that ''qualify,'' i.e., fit any of the activities listed under section 409(a)(7)(B)(i)(I) of the Act. This provision would not include expenditures under section 404(a)(2) of the Act. (We address expenditures under section 404(a)(2) later in this discussion.)

Comment: A few commenters asked whether States needed to include the income and resource requirements in the State's TANF plan. One of the commenters recommended that State plans clearly define and delineate all their programs so that there is a clear understanding of who is eligible, what services and benefits are available, and the TANF requirements and other provisions that apply to recipients of assistance. In addition, States should notify recipients in TANF programs (funded with either Federal or State funds) regarding their options and responsibilities, and the consequences of their choices. They also believed we should require States to develop MOE plans in advance of making expenditures and that States should file such plans with HHS and publish them in the State.

Response: We agree with the comments that it is appropriate for States to specify in their TANF plans the financial eligibility criteria (income and resources, when applicable) associated with all State or local programs for which MOE expenditures are claimed (including State funds that are commingled, segregated or separated from Federal TANF funds). Section 402(a)(1(A)(i) of the Act requires that the TANF plan outline how the State intends to provide assistance to needy families with (or expecting) children, and provide parents with job preparation, work, and support services to enable them to leave the program and become self-sufficient. Section 402(a)(1)(B)(iii) requires that the TANF plan indicate the objective criteria for delivery of benefits, the determination of eligibility, fair and equitable treatment, and opportunity for appeal of adverse actions. Neither section makes any distinction between Federal or State-funded assistance, service, or benefits. Since States can use either Federal or State funds to provide assistance, services, or benefits, we believe that the State's TANF plan is the appropriate place to indicate this information for both TANF and MOE expenditures.

If there is more than one activity within a program and the financial eligibility criteria differ per activity, the State must also indicate each different set of criteria in the TANF plan. For example, a State uses State funds in its transitional services program that consists of transportation and child care benefits. If the financial eligibility criteria are different for the two benefits, the State must indicate the financial eligibility criteria for each benefit.

In addition, although we do not require it, we believe that the plan is the most appropriate place for States to provide a brief description of each MOE program benefit provided to eligible families or eligible family members, as well as any other particular eligibility criteria tied to receiving the specific benefit (e.g., must be participating in the State's work experience component to receive a particular benefit). In § 265.9(c), we discuss the required information that States must submit annually. One of the required items includes naming each of the State's MOE programs and describing the major activities provided to eligible families under each such MOE program. To the extent this information is in the State's TANF plan, the annual reporting requirement may be met by referencing the plan.

In summary, the following information must be in the State's plan in order for us to deem the plan submission complete: (1) The financial eligibility criteria with respect to eligible families that are associated with the State's TANF program and all State or local MOE programs; and (2) a brief description of the corresponding program benefit provided to eligible families or eligible family members, if the State has used MOE funds (either commingled or segregated) to provide the benefit. It would also be helpful for States to include a brief description of the corresponding program benefit provided through separate State MOE funds. However, the information is not required in order to deem the State's plan submission complete.

We maintain a copy of each State's TANF plan, as well as any updates to the plan. As the Balanced Budget Act clarified, States need to update their plans, as appropriate, to reflect new or revised financial or programmatic requirements as a result of changes in State law or State policies. The plan is an important vehicle for ensuring public awareness of the various ways States are helping eligible families attain and maintain self-sufficiency.

Comment: A few commenters believed we should hold States accountable for complying with their plans for services and benefits under TANF (funded with either Federal or State funds) and penalize them if they fail to do so.

Response: The basic MOE penalty applies if a State fails to meet the basic MOE annual spending requirement with respect to eligible families as provided in this subpart. However, neither that penalty nor any other penalty provides authority for us to penalize a State for failure to carry out any part of its TANF plan.

We believe that States are committed to expending their funds in ways that best assist eligible families attain work and self-sufficiency. States have a very real stake in the success of welfare reform. States also recognize that they are ultimately accountable for their expenditure claims. States are audited annually or biennially and compliance with the basic MOE provisions is part of the audit.

Following publication of the rules, we will update the compliance supplement to give auditors detailed information about how to assess State reports on their MOE expenditures.

As part of their review, we will refer them to the information supplied in the TANF Financial Report and the supplemental information on MOE programs and MOE expenditures provided annually under § 265.9(c). This supplemental material provides information about the scope of eligible families served with MOE funds and the ways in which States expend their MOE funds to help eligible families.

In the compliance supplement, we will suggest auditing procedures that include reviews of all the MOE reports and an examination of issues such as the following: (1) Were all MOE expenditures reported for the fiscal year actually made during that fiscal year; (2) has the State adequately documented that reported MOE expenditures went to eligible families; (3) were the methodologies the State used to estimate the portion of program expenditures going to eligible families sound; (4) were all the reported expenditures consistent with the purposes of TANF; (5) were any expenditures made in violation of the prohibitions in § 263.6; (6) where applicable, did all expenditures meet the ''new spending test'' (e.g., for every such program, did the State properly identify whether the program existed in 1995 and only count expenditures above the total State expenditures in 1995); (7) were administrative costs within the 15-percent cap; and (8) were the expenditures consistent with the cost principles set forth in OMB Circular A–87.

We will use the results of the audits, together with our own analysis of the TANF Financial Report and the annual report, to identify situations where a State might be liable for an MOE penalty. For example, the fourth quarter TANF Financial Report would identify any State that reported MOE expenditures below the minimum 80-percent (or 75-percent) standard for the year. Either the TANF Financial Report or the annual report might identify types of expenditures that could be inconsistent with one or more of the requirements for ''qualified State expenditures.'' We might also undertake additional State reviews based on complaints that arise or requests from Congress.

Comment: A few commenters expressed concern regarding the eligibility determination process for different types of services or assistance. The commenters contend that the method of determining eligibility could vary depending on the service. For example, the method for determining a family's eligibility for diversion services may be more abbreviated than the process used to determine eligibility for ongoing TANF cash assistance. One commenter recommended that the regulations require an application for all State-funded benefits and verification that the family is actually eligible before any basic MOE expenditures may count.

Response: States decide the method(s) for determining whether the family consists of at least one child living with a parent or other caretaker relative and is financially eligible according to the appropriate income and resource (when applicable) criteria established by the State. As we mentioned in the above response, section 402(a)(1)(B)(ii) requires States to indicate in their plan the objective criteria for the delivery of benefits and the determination of eligibility. Nothing in this provision precludes a State from having different methods of determining eligibility for different types of services. However, we would note that 45 CFR 92.42 requires States to keep records to document claims and that States should, therefore, have and keep adequate records on eligibility.

Nevertheless, we remind States to pay attention to the TANF provisions that apply with respect to State-funded TANF assistance (i.e., to the use of commingled or segregated funds). States risk potential penalties if they violate certain TANF provisions. For example, section 408(a)(4) imposes a penalty on a State if the State's TANF program fails to participate in the Income and Eligibility Verification System (IEVS). The IEVS provision helps to improve the accuracy of eligibility determinations for applicants and recipients of TANF assistance.

States have an inherent interest in ensuring the integrity of their expenditures. Should a State learn of any material deficiency in its method for determining eligibility, we anticipate that the State would rectify it immediately, so that funds for services

are properly benefitting members of eligible families.

(c) Types of Activities

Comment: Several commenters recommended rewording § 273.2(d) of the proposed rule to avoid confusion regarding the applicability of ''assistance'' as defined under § 260.31 for basic MOE purposes. Commenters noted that States have the flexibility to count expenditures with respect to eligible families whether or not the expenditures meet the definition of assistance.

Response: As we explained earlier in this discussion, we believe that States may help eligible family members through an array of services that fall within the broad categories of activities listed in section 409(a)(7(B)(i)(I), including services that would not fall within the definition of assistance at § 260.31, such as nonrecurrent, short-term assistance. To clarify this point, we have reworded § 263.2(d) of the final rule and included similar language at § 260.31(c)(1).

(1) Cash Assistance

Comment: A few commenters requested clarification of the amount of State Earned Income Tax Credit (EITC) that can count toward the basic MOE requirement. One commenter noted that a State's EITC expenditures should count toward the basic MOE requirement even if none of the credit was ''actually sent'' to an eligible family member. For example, some States have ''nonrefundable'' EITC programs. Under a ''nonrefundable program,'' the EITC serves to reduce the family's State income tax bill. However, the State does not pay the family any EITC remaining if the credit amount is larger than a family's State income tax bill. Another commenter asked whether we intended the entire cash payment actually received by the eligible family to count toward basic MOE, even if a portion of the payment consists of a State income tax refund.

Response: We have addressed this issue extensively in the preamble for the new § 260.33. An EITC program can help to relieve the State income tax liability for working poor families by decreasing the family's State income tax liability. The family's tax liability is the amount of taxes owed prior to any adjustment for credits or payments. EITC can also supplement a family's income—if the credit amount exceeds the family's State income tax liability and the State pays the family the remainder (i.e., it refunds the credit amount remaining). Such a refund is equivalent to cash assistance and may count as a qualified expenditure because it is reasonably calculated to meet a purpose of the TANF program.

State income taxes represent revenue to the State. Credits that offset a family's State income tax obligation provide tax relief to the family while reducing the State's revenue. A reduction in taxes, or revenue foregone, is not an expenditure. Therefore, only the EITC amount that exceeds a family's State income tax liability prior to application of the EITC is an expenditure. It may count for basic MOE purposes if the excess amount is actually paid out (refunded) to the eligible individual. Section 409(a)(7) of the Act stipulates that only ''expenditures'' with respect to eligible families that provide a benefit or service that is reasonably calculated to meet a purpose of the TANF program count toward a State's basic MOE. Thus, if a State does not disburse or pay out any excess EITC remaining, there is no expenditure.

States must determine the amount of any excess EITC paid to a family in a fiscal year by reconciling the family's State income tax obligation for the year against the total EITC amount for which the family qualifies. Any excess EITC amount actually paid to the family may count toward the State's basic MOE. In this regard, any EITC that a worker receives in advance through his or her paycheck may only serve to offset the family's tax liability. Advance EITC would have to be reconciled at the end of the year, in the same manner as the lump-sum EITC credit, to determine the portion, if any, that exceeded the tax liability.

For example, a wage earner qualifies for a $200 earned income tax credit. His or her family has a $75 State income tax liability for the tax year. When reconciling at the end of the year, the first $75 of the credit is used to reduce the eligible family's State income tax liability to zero. This part of the calculation represents revenue foregone to the State and does not constitute an expenditure. If the State also elects to refund (pay out) the remaining $125 in EITC, then the $125 actually sent to the eligible family is a qualified expenditure and counts toward the State's basic MOE.

The same principles apply in the case of a worker who is otherwise due a State income tax refund. For example, suppose the wage earner qualifies for an earned income tax credit of $200. Assume further that the family has a $75 State income tax liability. Yet, through withholding, the wage earner paid a total of $150 in State income taxes throughout the year. After reconciliation at the end of the income tax year, the State owes the worker $150 from withheld State income taxes and $125 in excess EITC. If the State pays out the EITC owed and sends it to the family as part of a refund check in the amount of $275, only the EITC portion, or $125, counts toward the State's basic MOE.

Comment: One commenter asked to what extent other tax credits such as a dependent care credit, credit to purchase a car seat or health insurance, tax forgiveness credit, sales tax credit, and property tax credit count toward a State's basic MOE requirement. The commenter also asked to what extent, if any, other tax relief provisions such as personal or dependent exemptions or the standard or other forms of deductions count toward a State's basic MOE requirement.

Response: Tax provisions that only serve to provide a family with relief from State taxes, such as income taxes, property taxes, or sales taxes, represent a loss of revenue to the State, not expenditures to provide a benefit or service to eligible families. For example, exemptions and deductions are generally subtracted from total taxable income, serving only to reduce the amount of income subject to income tax. Therefore, such exemptions and deductions would not constitute an expenditure for the purposes of section 409(a)(7) of the Act. Similarly, tax credits that rebate, refund, or return to a family a portion of the State's tax revenue (e.g., property, sales, or income taxes paid by families to the State) would not count toward the State's basic MOE requirement. Such credits serve only to offset a particular tax (e.g., a State property tax credit that refunds a portion of property taxes paid). A reduction in tax burden is not an expenditure. There has been no direct outlay of State funds to provide a service or benefit to eligible families.

However, credits that go beyond tax relief and are paid to the eligible family would count toward a State's basic MOE requirement if the expenditure is reasonably calculated to meet a purpose of the TANF program. For example, like the earned income credit, a child care or dependent care credit is subtracted from the family's income tax obligation. The portion of the credit that exceeds the income tax liability and is paid to the family may count toward the State's basic MOE requirement. Should the family qualify for more than one refundable credit (e.g., an earned income credit and a dependent care credit), then the amount by which the total combined value of the allowable credits exceeds the family's State income tax liability may count for basic MOE purposes.

It is important to note that while States may describe elements of their tax provisions, such as exemptions or deductions, as ''expenditures,'' the provision may not actually be an expenditure. Similarly, States may differ in their methods of providing certain credits. For example, a sales tax or property tax credit may be claimed through the State's income tax system or through a separate process. Neither of these factors is material to determining whether some or all of the value of a credit, exemption, or deduction can count for basic MOE purposes. Accordingly, we urge States to carefully examine any tax initiative to determine whether it only serves to provide tax relief. If so, the money does not count for MOE purposes, even if a portion of the tax revenue is refunded or rebated to the eligible family as ''cash assistance.'' However, actual expenditures such as some refundable tax credits may count for MOE purposes if the portion of the credit that exceeds the family's income tax liability is sent to the eligible family and the refund is reasonably calculated to accomplish a purpose of the program. Should a State wish to consult with us on these matters, we are available for technical assistance.

Comment: Several commenters noted that lack of transportation to training, job interviews, jobs, child care, or other services that accomplish the purpose of the program represents one of the most significant barriers to individuals attaining and maintaining employment. There are frequently no public or private transportation services in rural areas, so the traditional approach of tokens or vouchers is inadequate. Transportation is also problematic in urban areas due to the mismatch of job and transit destination sites and traditional commuter services times and routes.

Commenters generally recommended that we give States sufficient flexibility to respond to individual travel needs by allowing a broad range of activities as MOE. Examples of suggested allowable transportation activities included brokerage and coordination pilot programs, initiation of services that increase access for TANF recipients to new development or redevelopment employment sites, subsidization of new transit services either directly or in combination with other Federal or State sources, sharing in the cost of extending existing public transportation services, and developing necessary transportation infrastructure. One commenter added that we should tie transportation development costs for basic MOE to coordination mechanisms among human services agencies, State departments of transportation, and private transportation providers.

One national organization commented that, if public transit providers must use the cost allocation method, our rules would be unduly restrictive and could impede the ability of States to provide cost-effective services. The commenter suggested classifying such services as contracted services for TANF clients to be paid for by TANF agencies, with any non-TANF riders considered incidental. Another commenter recommended adding a section under this subpart to address when transportation-related expenditures count for basic MOE purposes.

Two commenters referred to the WtW program by suggesting that qualified transportation expenditures for basic MOE purposes should include transportation services provided through the State's WtW program and by clarifying that States could use TANF funds to support transportation services consistent with the WtW block grant program.

Response: We agree that transportation is a critical element in helping eligible individuals find and keep jobs. President Clinton recognized the importance of this issue in his 1998 State of the Union address. To help individuals on welfare get to work, he proposed an Access to Jobs initiative in the transportation reauthorization bill. Congress approved this proposal as the Job Access and Reverse Commute grant program in the Transportation Equity Act for the 21st Century (TEA–21), enacted in June 1998.

On May 4, 1998, we issued written guidance jointly with the Departments of Transportation and Labor on some of the ways in which States could use TANF and WtW funds to break down the transportation barriers for eligible individuals (Temporary Assistance for Needy Families Program Policy Announcement TANF–ACF–PA–98–2). Most of the examples could also serve as examples for the use of basic MOE funds. We updated this guidance to incorporate the provisions of TEA–21 in TANF–ACF–PA–98–5, dated December 23, 1998. We anticipate issuing additional guidance on the use of funds shortly after publication.

We do not think that it is necessary to add specific regulations to address transportation expenditures.

Transportation expenditures with respect to eligible families count as basic MOE if they meet all the requirements under section 409(a)(7) of the Act and this subpart. For example, under section 409(a)(7)(B)(i)(I)(aa) of the Act, transportation expenditures count if they are a form of cash assistance that is reasonably calculated to accomplish a purpose of the program (e.g., reimbursement for mileage, gas, public transit fare, auto repairs/insurance, or a basic cash allowance for transportation needs to go to or from work or training). Also, under section 409(a)(7)(B)(i)(I)(ee) of the Act, other types of transportation expenditures count if they reasonably accomplish a purpose of the TANF program, such as promoting job preparation and work. A broad range of transportation activities are possible within this category. We included some examples of such activities in the joint guidance cited above. However, we remind States that applicable TANF rules apply to State-funded transportation assistance (as defined in § 260.31) provided under the TANF program. (We discussed the implications of State-funded assistance in an earlier response.)

We also remind States that only qualified transportation expenditures with respect to eligible families count toward the basic MOE requirement. Congress clearly did not intend to include expenditures for the public at large. Thus, it is improper to claim as basic MOE general expenditures required to carry out other responsibilities of a State or local government and benefitting the public at large. However, a State could contract with a public or private transit agency for transportation services for eligible family members. Under such a contracting arrangement, a transit company could serve noneligible individuals so long as the State does not claim as State MOE the funds used to pay for, or subsidize, use by these noneligible individuals.

A State could also claim as MOE those start-up, program, and administrative costs that are attributable to eligible family members under a State or local transportation initiative (e.g., to broker transportation services) that is consistent with TANF goals, but targeted to a larger low-income population or more broadly to a low-income area.

States must allocate costs when State or local programs or agencies share costs, e.g., the TANF agency shares the use of vans or buses with a senior citizen program or shares in the purchase of transportation services.

We know that many States and locales have already made tremendous strides toward breaking down the transportation barriers faced by eligible family members. However, we also know that Federal TANF and State MOE funds are insufficient to overcome all transportation deficiencies. The recently

passed Job Access and Reverse Commute grant programs will give States additional flexibility in developing and providing transportation services.

The Job Access program provides competitive grants to assist States and localities in developing flexible transportation services to connect welfare recipients and other low-income persons to jobs and other employment-related services. The Reverse Commute grant program is for projects that will provide transportation services to suburban employment centers from urban, rural, and other suburban locations for all populations. The Mass Transit Account of the Highway Trust Fund and the General Fund finance both programs. However, the amount of the Federal grant under either program may not exceed 50 percent of the total project's cost. The balance must be met locally. Thus, a 50/50 Federal/local match is required under both programs.

In this regard, we remind States of the prohibition under section 409(a)(7)(B)(iv)(IV) of the Act and § 263.6(c) of this subpart stipulating that any State funds expended as a condition of receiving Federal funds under other programs do not count toward the State's basic MOE. Thus, any State funds used to meet the cost-sharing requirements of the Job Access and Reverse Commute grants program do not count for basic MOE purposes. However, in this case, Federal TANF funds may be used to satisfy non-Federal match requirements of another program (within specified monetary limits).

In addition, section 409(a)(7)(B)(iv)(III) of the Act and the regulatory text at § 263.6(e) of this subpart expressly provide that State funds expended to meet the WtW matching requirements do not count toward a State's basic MOE. Thus, States may not double-count expenditures to provide transportation services for individuals participating in an allowable WtW employment activity.

The statute is equally clear regarding expenditures for supportive services, such as transportation, to help eligible family members who are WtW participants. Section 403(a)(5)(C)(i)(VI) of the Act provides that a State may use WtW funds to provide supportive services to eligible participants only "if such services are not otherwise available." A State could use basic MOE funds to provide transportation services consistent with the WtW block grant program because the WtW and TANF programs share the same purposes. But, as explained above, the expenditures do not count for basic MOE purposes if the State also used these expenditures toward the required WtW match under section 403(a)(5) of the Act.

(2) Any Other Use of Funds Allowable Under Section 404(a)(1)

Comment: One commenter recommends that we allow States to claim expenditures toward basic MOE that were formerly allowable under a State's AFDC–EA program. Another commenter specifically asked whether services paid under a housing assistance program qualify for basic MOE purposes. The housing assistance component provides payment for rent, security deposit, and utilities to prevent and/or end homelessness or near homelessness. A third commenter asked whether expenditures for micro-entrepreneurship development services qualify for basic MOE purposes. The commenter believes this approach fosters employment opportunities in rural areas through self-employment options.

Response: Section 409(a)(7)(B)(i)(I)(ee) of the Act permits any activity with respect to eligible families that is reasonably calculated to accomplish the purpose of the TANF program to count for basic MOE purposes. For example, one purpose of the program is to provide assistance to needy families so that children may be cared for in their own homes or in the homes of relatives. Thus, some (but not all) emergency assistance and services with respect to eligible families, which had been previously provided by a State under its AFDC–EA program, would meet this purpose and could count for basic MOE purposes. We believe that emergency housing assistance services could meet this purpose as well. However, only the expenditures made with respect to eligible families count for basic MOE purposes. (Refer to § 263.5 for discussion of the "new spending" limitation on certain MOE program expenditures.)

Another purpose of the program is to end the dependence of needy parents on government by promoting job preparation, work, and marriage. Micro-entrepreneurship services promote job preparation and work. In this regard, a State may also deposit State funds into the eligible family member's Individual Development Account (IDA) to help with business capitalization. The funds count once toward the basic MOE requirement—in the fiscal year in which the State deposits the money into the eligible family member's IDA. The State could not use the IDA balance carried forward to the next fiscal year to meet the basic MOE requirement for the next fiscal year.

(3) Medical and Substance Abuse Services

Comment: A number of commenters supported our clarification in the preamble to allow States to use State funds to provide drug and alcohol treatment services to eligible family members when these services assist in accomplishing a purpose of the program. Nearly all the commenters requested that we add the clarification to the final regulation.

One commenter found the need to separate medical from nonmedical substance abuse treatment services problematic and unrealistic as both types of services are lacking in rural areas. The commenter also noted that child care and transportation costs related to these services should also count toward a State's basic MOE. Another commenter suggested that we provide guidance in the preamble to differentiate medical from nonmedical alcohol and drug treatment services.

Two other commenters felt that medical services in connection with gaining and retaining unsubsidized employment (e.g., pre-employment services that include physical examinations) should count toward the basic MOE.

Response: We agree that allowing expenditures with respect to an eligible family member for nonmedical substance abuse treatment is an important clarification and have added it to the final regulation.

We did not intend to imply that substance abuse treatment must be exclusively nonmedical in nature for the nonmedical services to count for basic MOE purposes. We recognize that drug and alcohol abuse treatment services may include medical as well as nonmedical activities. However, if States wish to use commingled State TANF funds for substance abuse treatment services, they have the responsibility to develop policies that distinguish between expenditures for the provision of medical services and nonmedical services. The policies must reflect a reasonable interpretation of the statutory language.

Section 408(a)(6) of the Act expressly excludes the use of Federal TANF funds to provide medical services except for pre-pregnancy family planning activities. The same prohibition applies to any commingled State funds expended to treat an eligible family member for drug and alcohol abuse. Commingled State funds used to provide nonmedical services, such as substance abuse services, to an eligible family member would count toward basic MOE if the service is reasonably

calculated to accomplish a purpose of the program, e.g., help the individual prepare for work, find, or keep a job.

The prohibition on medical expenditures does not apply to segregated State TANF funds or separated State funds. Therefore, States may count medical expenditures with respect to eligible family members toward the basic MOE provided these expenditures are consistent with the purposes of the program and are not matched by the Medicaid program or otherwise prohibited under section 409(a)(7)(B)(iv) of the Act or § 263.6(b) and (c) of this subpart.

We again remind States that the drug and alcohol abuse treatment services with respect to eligible families must be consistent with the purposes of the program to count toward the State's basic MOE requirement. If so, then by extension, expenditures for other supportive services such as transportation and child care that facilitate the eligible family member's ability to access and complete substance abuse treatment may also count for basic MOE purposes, if the MOE requirements are met. (Refer to § 263.3 for discussion of the limitation on certain child care expenditures.)

We agree that pre-employment services is an example of a qualified activity because it accomplishes a purpose of the program. Therefore, by extension, the associated medical expenditures would count toward basic MOE if the State uses segregated or separated funds to pay for the services.

(4) Juvenile Justice

Comment: We received several comments regarding our discussion of juvenile justice expenditures. Most of the commenters opposed our conclusion that juvenile justice expenditures do not count for basic MOE purposes because the expenditures do not meet any of the purposes of the TANF program. However, the commenters did not specifically explain how the purposes are met.

Response: As we explained in detail earlier in our discussion, juvenile justice expenditures do not count for basic MOE purposes. The principal purpose of a child's placement in the juvenile justice system is to protect society because of the child's behavior, not to care for the child in his or her own home (purpose 1). Since the focus is to address the child's needs, expenditures to care for the child in these living situations does not serve to end the dependence of needy parents on government benefits by promoting job preparation, work and marriage (purpose 2). The remaining two purposes do not even remotely relate to this situation. Thus, it is not an allowable use of funds under section 404(a)(1) of the Act.

In some States, Federal TANF funds may support juvenile justice programs pursuant to section 404(a)(2) of the Act. However, the basic MOE requirement under section 409(a)(7) of the Act expressly does not count expenditures for services or activities that only fall under section 404(a)(2). Thus, it does not cover benefits and services for a child removed from his or her home and receiving care in a correctional facility or juvenile residential facility. States that were previously authorized to cover the costs of children in the juvenile justice system under their formerly approved AFDC-Emergency Assistance plans would need to use Federal TANF funds for this purpose.

Clearly, expenditures on eligible families for services that are reasonably calculated to accomplish the purpose of the program do qualify for basic MOE purposes. For example, a State may wish to provide family preservation services so that an eligible child family member may be cared for in his or her own home (purpose 1). Such assistance could include family or individual counseling services or parenting training to improve family functioning, referrals to outside service providers who could help an ''at risk'' child or family function better, and associated assessment and case management activities.

(5) State ''Rainy Day'' Funds

Comment: One commenter noted that States have a long history of creating rainy day funds or special reserves to cover contingency needs. States recognize the need to be fiscally prudent in the anticipation of caseload increases, natural disasters, economic declines, and increasing participation rates. But the commenter believed the language in the proposed rule limits State flexibility to use State funds for this purpose.

Response: Section 409(a)(7)(A) and (B) of the Act stipulate that only qualified expenditures made with respect to eligible families count toward a State's basic MOE. Placing funds in a reserve or rainy day fund does not represent an expenditure. While we agree that it may be fiscally prudent to create a rainy day fund or a reserve, the money in the fund does not count for basic MOE purposes until the fiscal year in which the State actually expends funds on behalf of eligible families in ways that meet the requirements of section 409(a)(7) of the Act and this subpart.

(6) Administrative Costs

Comment: Several commenters raised questions about how the administrative cost cap was applied to MOE and separate State programs. A few did not want a cap on the administrative costs of separate State programs, believing that the PRWORA does not authorize us to cap those administrative costs. Three commenters took exception to the application of the 15-percent administrative cost cap to separate State programs. The three commenters believe that such ''separate State programs'' should be excluded from coverage of the definition.

Response: We believe these comments are a result of confusion about the proposed regulatory language. The MOE administrative cost cap is not a limit on the administrative costs of separate State programs. Rather, it is a limit on the amount of administrative costs that can count as MOE. Section 409(a)(7)(B)(i)(I)(dd) clearly limits the amount of administrative costs that can count as basic MOE. We have revised the regulatory language at § 263.2(a)(5) to clarify the distinction.

We also noted an error in the proposed TANF reporting form and the accompanying instructions that may have added to the confusion. The instructions provided separate columns for reporting of expenditures from MOE funds, one for State TANF expenditures and one for separate State programs. It then indicated how administrative costs would be determined ''for each of these columns.'' This language suggested that there were two separate caps, when that is not the case. We have corrected the instructions for the form.

Comment: Two commenters indicated that administrative spending for the TANF program would probably never involve a specific payment to, or on behalf of, a specific eligible family. Yet this is a qualified expenditure. Therefore, the commenter thought all types of spending should qualify toward the basic MOE.

Response: The different treatment of administrative costs is based on statutory distinctions. According to section 409(a)(7)(B)(i)(I)(dd) of the Act, administrative expenses under all programs means ''[A]dministrative costs in connection with the matters described in items (aa), (bb), (cc), and (ee).'' Therefore, the statute includes as MOE, administrative expenses if the expenditure relates to carrying out another qualified activity that helps eligible families.

Comment: One commenter observed that the definition of administrative costs under § 273.0(b) of the proposed

regulation applies to State MOE expenditures since the use of State MOE funds have the same administrative cost cap as Federal TANF funds.

Response: The commenter correctly noted that the definition of administrative costs applies whether State funds or Federal TANF funds are used to pay these costs.

Comment: Two commenters supported our proposal to exempt State expenditures used toward information technology and computerization needed for tracking or monitoring as required by title IV–A. One commenter noted that while section 409(a)(7)(B)(i)(I)(dd) of the Act does not clearly state that this exemption applies, nevertheless, States are facing massive systems needs as a result of welfare reform. In addition, the exception for technology and computerization should include costs for contracts to develop new programs; staff needed to install and maintain additional systems; staff collating, in-putting and analyzing required tracking and monitoring data; training costs for new hardware and software; and preparing the reports and other documents related to the tracking and monitoring mandates.

Response: We have retained our proposal that the same exception given under section 404(b)(2) with respect to costs related to information technology and computerization needed for tracking and monitoring apply to State-funded administrative costs in connection with qualified expenditures.

We addressed the treatment of computer-related costs in the discussion of the definition of administrative costs at § 263.0. Refer to that section for a full discussion of issues raised regarding information technology and computerization needed for tracking or monitoring. Basically, this discussion affirms that certain systems costs may be excluded in determining whether a State is within or exceeded the 15-percent limitation placed on administrative expenditures. It also provides guidance about the scope of that exclusion.

Comment: One commenter said that the cap on administrative costs does not apply to additional State dollars that a State must expend if assessed a penalty.

Response: The commenter is correct. Section 409(a)(12) of the Act requires a State to expend additional State funds under its TANF program to replace any loss of Federal grant funds due to a penalty. The 15-percent limit under section 404(b) applies only to Federal TANF funds, and, thus, does not apply to the State replacement funds under section 409(a)(12). Further, as the statute precludes the use of replacement funds to meet the MOE requirement, they are not subject to the MOE rules, including the MOE cap on administrative expenditures. However, they must otherwise be allowable expenditures under the State's TANF program.

Section 263.3—When Do Child Care Expenditures Count? (§ 273.3 of the NPRM)

Overview

In the NPRM preamble we explained that there were certain restrictions on the child care expenditures that could count for basic MOE purposes. First, only child care expenditures used to assist eligible families under the State's TANF criteria count toward the State's basic MOE. Under § 263.2 (formerly § 273.2), we indicated that eligible families mean families that have a child living with a parent or other adult caretaker relative (or consisting of a pregnant woman) and are financially needy per the appropriate TANF income and resource standards (when applicable) established by the State under its TANF plan. Thus, not all State expenditures to provide child care services would necessarily qualify for basic MOE purposes, particularly if the eligibility criteria for the child care services are broader than the State's TANF criteria, e.g., under the Child Care Development Fund (CCDF).

Second, section 409(a)(7)(B)(iv) of the Act establishes four general restrictions on State expenditures. (These restrictions are listed in § 263.6.) Two of the restrictions, at subsections 409(a)(7)(B)(iv)(IV) and 409(a)(7)(B)(iv)(I), apply to child care expenditures.

Subsection 409(a)(7)(B)(iv)(IV) generally excludes any State funds expended as a condition of receiving Federal funds under other Federal programs from counting toward a State's basic MOE. Thus, Congress prohibited "double-counting." However, this subsection also provides an exception to this restriction for child care expenditures (i.e., the State's CCDF MOE and the State's share of matching funds). State child care expenditures used to meet the child care MOE requirement or to receive Federal matching funds under the CCDF may also count toward meeting the State's basic MOE requirement if the expenditures are made on behalf of members of an eligible family.

The amount of State child care expenditures that may count for basic MOE purposes is limited to the State's share of expenditures in FY 1994 or FY 1995, whichever is greater, for the former title IV–A child care programs, i.e., the AFDC/JOBS child care, transitional child care, and At-Risk Child Care programs. This capped amount is the same amount as the State's child care MOE amount, for purposes of qualifying for child care matching funds.

If a State has additional State child care expenditures, i.e., expenditures that have not been used toward meeting the child care MOE requirement or to receive Federal matching funds under CCDF, these expenditures may count toward the State's basic MOE, provided the expenditures meet all other requirements and limitations set forth in subpart A of this part. Subsection IV does not limit the amount of such additional child care expenditures that may count for basic MOE purposes.

Subsection 409(a)(7)(B)(iv)(I) excludes any expenditures that come from amounts made available by the Federal government. Therefore, Federal TANF funds transferred from the TANF program to the Child Care and Development Block Grant (also known as the Discretionary Fund of the CCDF) would not count toward MOE. Neither would Federal TANF funds directly received under CCDF (or any other program that allows for child care).

Comments and Responses

We received a number of comments on this section. Some commenters found the information regarding expenditures that could count helpful, especially since States are making significant investments in child care. Others thought that the preamble was confusing because it did not clearly distinguish between child care expenditures that are subject to a dollar limit (and therefore would not count in the entirety toward the basic MOE) and those that can count without limit. A few commenters recommended that the final regulations at § 263.3(a) (formerly § 273.3(a)) clearly explain which child care expenditures count rather than merely cross-referencing the statutory provision.

Several commenters expressed concern that the definition of "eligible family" deters States from counting child care expenditures under the State's child care program for transitional and at-risk families. We address this and other comments in the discussion below.

Comment: Some commenters noted that the wording in this section does not clearly explain which expenditures do and do not count toward the State's basic MOE requirement. The commenters thought that we should add a clarification to the final regulations.

Response: States may receive an allocated amount of Federal matching funds under the matching fund component of the CCDF. To receive its share of these matching funds, the State must meet a maintenance-of-effort (MOE) requirement. The child care MOE requirement is a specific dollar amount that we calculated for each State based on their FY 1994 or FY 1995 State child care expenditures under the title IV–A child programs. Thus, under the CCDF matching fund, States must expend State-only dollars that equal their child care MOE level and may claim Federal matching funds (up to the allocated amount) for State funds expended beyond the child care MOE level to provide CCDF-funded child care services. A State may also count these State-funded child care expenditures toward the State's basic (TANF) MOE as long as the expenditures also meet the requirements under section 409(a)(7) of the Act and this subpart. However, the amount that may be counted for basic MOE purposes is limited to State's child care MOE amount. States should note that while the basic MOE limit for double-counting child care expenditures is the same amount as the child care MOE amount, this does not mean that the State may use only child care MOE expenditures. For example, if a State's annual child care MOE requirement is $5 million, then the State may only count up to $5 million of its CCDF matching fund expenditures toward its annual basic MOE requirement. The State could claim the $5 million in child care expenditures from either expenditures used to meet the State's child care MOE requirement or expenditures used to receive CCDF Federal matching funds.

It is not unusual for a State to expend in excess of the funds needed to draw down CCDF funds to provide child care services. There is no dollar limit on counting toward basic MOE State expenditures to provide child care assistance that have not been used to meet the CCDF matching fund requirements. We have clarified this policy in the regulatory text. At the same time, we remind States of the "new spending" provision at § 263.5 that limits the amount of basic MOE expenditures that may count in certain pre-existing basic MOE programs, including certain child care programs.

For pre-existing child care programs (current State or local programs also operating in FY 1995) that were not AFDC-related programs, States may only claim "new spending" toward the basic MOE requirement—namely, qualified State expenditures in the current year with respect to eligible families that exceed what the State spent on that program in FY 1995. The AFDC-related child care programs included the AFDC, At-Risk, and transitional child care programs. The "new spending" provision does not apply to expenditures for child care services that would have been an allowable expenditure under these former title IV–A child care programs.

Hence, in terms of a child care program subject to the "new spending" provision, three requirements apply for the expenditure to count as basic MOE. First, only the "new" expenditures, those in excess of the FY 1995 program expenditures, potentially count. Second, if the expenditures have been used to meet the child care MOE requirement or to receive CCDF matching funds, the maximum amount of excess expenditures that can be double-counted is limited to the State's child care MOE amount. For those expenditures that have not been used to meet the child care MOE requirement or to receive CCDF matching funds, the excess may count as basic MOE, up to the actual amount of expenditures made outside of the CCDF matching fund requirement. Finally, if none of the expenditures in the child care program have been used to meet the child care MOE requirement or to receive CCDF matching funds, the total amount of the excess can be counted toward basic MOE.

Comment: Several commenters expressed concern that State expenditures to provide child care services to families transitioning off TANF assistance or at risk of becoming dependent on TANF assistance do not count for basic MOE purposes because of the restricted definition of eligible families. One commenter suggested that we amend the regulation to recognize State programs geared to enabling low-income families to maintain their jobs through the provision of child care. The commenters contend that we should consider any family who is financially needy according to the State's child care eligibility criteria an eligible family for basic MOE purposes. Therefore, any State spending on its child care program would count toward a State's basic MOE requirement.

Several other commenters concurred, writing that all of the State's child care expenditures under the now repealed title IV–A child care programs, which included expenditures for working families to transition off the TANF assistance program or at risk of needing TANF assistance, should count toward the basic MOE requirement, up to each State's child care MOE amount. They noted that there is no statutory requirement that an eligible family must actually receive TANF cash assistance for child care expenditures to count for basic MOE purposes.

Response: We refer you to the extensive discussion regarding the definition of eligible family under § 263.2 of this subpart. There, we reaffirm that an eligible family must consist of child living with his or her parent or other caretaker relative (or consist of a pregnant woman). The family must also be financially needy according to the appropriate income and resource (when applicable) criteria established by the State and contained in its TANF plan. However, we also mention that we never intended that States be locked into a single income and resource standard, such as the one a State uses to determine whether a family is financially eligible to receive TANF cash assistance. States are free to establish different income and resource (when applicable) criteria based on the range of families that it wishes to serve or type of services it wants to provide. We also recognize that eligible family members do not necessarily have to receive TANF cash assistance or any other benefit or services through the TANF program.

Thus, the rules would not preclude States from providing child care benefits to help families who are transitioning off of TANF assistance or at risk of needing TANF assistance or other low-income families. Nor would they prevent a State from using the financial eligibility limits for child care services and activities applicable to the use of CCDF funds or the financial eligibility criteria applicable to a State's own separately funded child care program.

Comment: One commenter noted that the NPRM gives the impression that we consider child care important for children up to the age of six, but not for children age six or older. The commenter recommends rulemaking on this issue.

Response: We believe the commenter was referring to the proposed rule at § 271.15, which provided that a State could not reduce or terminate assistance to a single custodial parent caring for a child under age six for refusing to engage in required work, if the parent demonstrates an inability to obtain needed child care. This provision, found in § 261.15 of the final rule, reflects the statutory provision at 407(e)(2), which expressly limits the sanction exception to a single custodial parent caring for a child under age six.

This provision does not represent our perspective regarding the importance of child care for children age six and over. We recognize that child care is a critical

supportive service for families moving from welfare to work. However, our authority to regulate in this area is limited to the State penalty provision associated with this child care exception at § 261.51 of the final rule.

Comment: One commenter indicated that the State agency may not know if it needs to utilize any child care MOE expenditures to satisfy the basic MOE requirement until the final quarter of the fiscal year.

Response: The commenter may be reacting to the requirement to report expenditures quarterly. Although the report is quarterly, the expenditures reported are cumulative. The basic MOE spending requirement is an annual requirement. Thus, the reported expenditures could have occurred in the quarter represented by the report or any prior quarter in the fiscal year.

A State may choose to apply the child care expenditures that it made to meet the CCDF matching fund requirement toward satisfying its basic MOE requirement (up to the dollar limit). It is not a requirement. The State may apply such expenditures toward its basic MOE requirement anytime during the fiscal year.

The commenter may also be pointing out a potential issue for States that depend upon expenditures in other State and local programs for meeting the basic MOE requirement. To the extent such other programs are not under the control of the TANF agency, the TANF agency will need to maintain strong communications with the other agencies operating these programs in order to track and report expenditures, as well as to ensure that the State will be in compliance with the basic MOE requirement at the end of the year.

Section 263.4—When Do Educational Expenditures Count? (§ 273.4 of the NPRM)

Overview

Only expenditures on educational services or activities that a State targets to eligible families to increase self-sufficiency, job training, and work may count toward a State's MOE. The statute excludes educational services or activities that are generally available, including through the public education system. As the conferees explained in H.R. Rep. No. 725, 104th Cong., 2d sess., p. 277, States may not count as MOE ''any expenditure for public education in the State other than expenditures for services or assistance to a member of an eligible family that is not generally available to other persons.''

Expenditures on special services that are targeted to ''eligible families'' and are not generally available to other residents of the State may count. These could include contracted educational services or activities that provide special classes or expand the capacity of existing programs, for example, to provide: targeted services for teen parents in high schools or other settings; training in English as a second language for eligible immigrants; remedial education to achieve basic literacy; courses for high school equivalency (GED) certificates; or pre-employment or job-readiness activities.

We also note that expenditures on supportive services, such as transportation, to assist a member of an eligible family in accessing educational activities may also count toward a State's MOE, either as cash assistance or another type of benefit or service consistent with the purposes of the Act. (See §§ 263.5 and 263.6 for other general restrictions on these expenditures.)

Comments and Responses

We did not receive many comments on this section. The comments that we did receive focused on two areas: the requirement that the education activities must not be generally available to other residents of the State, and the use of the term ''targeted.'' We address these concerns and others below.

Comment: Two commenters thought the term ''targeted'' was misleading and needed clarification. As written, qualified educational expenditures could be ''targeted'' to eligible families, yet the recipients of the services may be persons who are not members of eligible families.

Response: We agree. The statute clearly stipulates that only services with respect to eligible families count toward the State's basic MOE requirement. We have therefore reworded the regulation to say that the services must be ''provided to'' eligible families.

Comment: A number of commenters voiced concerns regarding the meaning and operation of the exclusion of expenditures for educational services that are generally available to other residents of the State. One commenter noted there is no specific definition of services that are generally available to the public. Some of the commenters believed that States could be discouraged from using State MOE funds for education. Providing educational services that are generally not available to the public could result in operating segregated classes for eligible families in order to have the expenditures count for basic MOE purposes. In fact, the commenters noted that the examples of educational activities for eligible families given in the NPRM are no different than those provided by the public education system. Thus, the provision essentially eliminates a State's ability to count educational activities or services toward the basic MOE requirement whenever the services are made available to other residents of the State. As one commenter put it, ''[W]ho pays for the assistance is irrelevant, as is whether anyone from the general public also has access. The proposed rule limits States' ability to maximize its resources.''

One commenter also raised concerns regarding the potential impact that expenditures for educational services for eligible families will have on current public education programs funded by the State. The educational activities for basic MOE purposes may come at the expense of similar education services and activities provided by the traditional public education system.

Another commenter asked whether the restriction applies to post-secondary public institutions.

Response: We modified the regulatory text to provide a little more guidance. The modified language incorporates language from a similar provision under title XX at section 2005(a)(6) of the Act. More specifically, the title XX provision excludes expenditures for the provision of any educational service that the State makes generally available to its residents without cost and without regard to their income. We thought this additional language was helpful and have added it to the regulatory text. Under TANF and title XX, we believe Congress intended to prohibit States from substituting program funds for existing expenditures from general funds on the traditional, free public education system. Thus, general fund expenditures for traditional, free public education do not count toward the State's basic MOE requirement.

Accordingly, we do not think that the exclusion would cover post-secondary educational or vocational programs in the State unless all residents of the State may attend the post-secondary institution without cost and without regard to their income.

We do not think it is appropriate for us to define activities that are not generally available to persons who are not members of an eligible family. We defer to the States to decide appropriate educational activities for MOE purposes, i.e., to increase job training, self-sufficiency, and work.

Basically, a State may use MOE funds to expand existing educational services by contracting for additional services for eligible family members or by funding brand new activities. States do not need to segregate the activities, services, or

classes. They may even use the physical facilities of the public education system. Other residents of the State may participate in the funded activities so long as the State does not count, as MOE, funds used to subsidize or pay for persons who are not members of an eligible family. States may also count, as MOE, funds used to provide a service for eligible families in a part of the State or locale where the service does not exist.

Similarly, States may count as MOE funds used to contract for, or share in, the costs of providing educational activities on job sites (e.g., ESL classes). In this particular situation, other employees at the site who are not members of eligible families could attend the classes. However, as previously mentioned, a State may not count, as MOE, any funds used to subsidize or pay for persons who are not members of an eligible family.

In summary, a State may count, as MOE, funds used to pay costs (e.g., fees or tuition) to enable an eligible family member to attend a class or participate in an educational activity. Nonexcluded educational expenditures with respect to eligible families count for basic MOE purposes if the activities are designed to increase self-sufficiency, job training, and work.

We remind States to allocate costs that are associated with more than one State or local program or agency properly.

Comment: One commenter recommended that the State substantiate its basic MOE expenditures by providing overall budget information on its education services and programs, not just those provided to eligible families. The State should also provide a comprehensive budget picture of support for education activities and services for the entire education agency responsible for TANF-related education services—thus, reflecting any shifts in funds between the traditional, free education programs in public schools and the TANF-related education services.

Response: We do not believe it is necessary for the State to regularly submit such information. However, States are subject to audits annually or biennially pursuant to the Single Audit Act. The audit includes a review of a State's compliance with MOE requirements. Under 45 CFR 92.42, States are responsible to have a process designed to achieve reliability of financial reporting and compliance with applicable laws and regulations, including retention of background documentation that validates such reports. The audit findings include any questioned costs. We are informed of all audit findings.

Other studies, or reviews by OIG or GAO, may be conducted. Such reviews could cover processes, such as a State's budgetary process, that are generally beyond the scope of an audit. Further, if appropriate, for example, audits may also be conducted as a result of requests by Congress or in response to complaints from individuals or organizations.

Finally, we have made changes to the reporting on MOE programs at § 265.9(c) that should provide a clearer picture of educational activities being funded by MOE.

Comment: One commenter indicated that using State funds to enhance access to education for low-income families is an important way of helping families out of poverty. At the same time, States are concerned with the risk for penalties if they use separate State funding to provide financial aid for low-income families. The commenter was concerned that while the State may view education as an effective means of advancing work rather than avoiding the work participation requirement, we might view it as an inappropriate diversion.

Another commenter questioned whether State-funded expenditures to permit a member of an eligible family to obtain no more than the first baccalaureate degree or one vocational education program certificate as part of ''job skills training directly related to employment'' counts for basic MOE purposes. These educational activities are only available to students who meet other strict criteria established under State law (which include a recent work history; enrollment in an accredited or approved State university, community college, or other vocational school or training program; and maintaining a cumulative grade point average of at least a ''C'').

Response: The inherent effect of any separate State program is that the TANF requirements do not apply. In the NPRM, we expressed concern that States might use separate programs to avoid the work requirements or to avoid returning a share of their child support collections to the Federal government. As a result, we proposed several measures to counteract this possibility, including denying certain penalty relief to States. In the final rule, we decided to eliminate the proposed link between a State's decision to operate separate State programs and its eligibility for penalty relief. However, we still intend to gather information that will enable us to monitor the nature and scope of such programs. Refer to the preamble, section entitled ''Separate State Programs'' for a full discussion of this issue.

We have been persuaded that States are using both separate State programs and the TANF program to serve a variety of policy purposes that do not seem to be designed to avoid TANF requirements. For example, States are working to increase the economic viability of families by providing financial aid for post-secondary education and supporting other education and training activities on a selective basis. Unless excluded, educational expenditures with respect to eligible families count for basic MOE purposes if the activities are designed to increase self-sufficiency, job training, and work. These activities may be under the TANF program or apart from the TANF program. In either case, we hope that State and local officials are working with educators, post-secondary institutions, and the business community to design appropriate opportunities for families consistent with the goals of TANF.

As a point of clarification, the list of work activities in section 407 of the Act (and § 261.30 of these rules) determine what is countable for the purpose of the State's work participation rates. However, they do not limit the nature or type of educational or training services the State may provide with Federal TANF or State MOE funds.

Section 263.5—When Do Expenditures in State-Funded Programs Count? (§ 273.5 of the NPRM)

Overview

We explained in the NPRM that section 409(a)(7)(B)(i)(II) establishes limits on the amount of expenditures that may count when the MOE expenditures are for activities under separate State or local programs. The heading for the provisions under this section indicates that ''transfers from other State and local programs'' cannot count toward a State's MOE. In the months following enactment, we received numerous questions about this language.

We do not believe that the language intended to convey a literal or physical transfer of funds. Instead, we believe that Congress wanted to prevent States from substituting existing expenditures in any pre-existing outside programs for cash welfare and related assistance to needy families and to prevent States from claiming such existing expenditures as expenditures for MOE purposes.

Therefore, section 409(a)(7)(B)(i)(II)(aa) provides that the money spent under State or local

programs may count as MOE only to the extent that the expenditures exceed the amount expended under such programs in the fiscal year most recently ending before the date of enactment (August 22, 1996). Thus, States may count only additional or ''new'' expenditures, i.e., expenditures above FY 1995 levels. Like some commenters, we call this the ''new spending'' provision.

Section 409(a)(7)(B)(i)(II)(bb) provides an alternative limitation. We believe that this provision was intended as an exception to the ''new spending'' provision under (aa). Under provision (bb), State expenditures under any State or local program during a fiscal year may count toward a State's MOE to the extent that the State is entitled to a payment under former section 403 as in effect before the date of enactment with respect to the expenditures. We interpret this to mean that State funds expended under State or local programs that had been previously authorized and allowable under the former AFDC, EA, and JOBS programs in effect as of August 21, 1996, may have all such expenditures count toward the State's MOE. In other words, the limit under (aa) does not apply to what would have formerly been expenditures under the title IV–A program; there is no requirement that these expenditures be additional or new expenditures, above FY 1995 levels.

Comments and Responses

We did not receive many comments on this section. But some of the comments that we did receive raised some important issues regarding the concept of ''separate'' State or local programs, as well as the meaning of the exception to the ''new spending'' provision. One commenter also questioned the calculation process for determining any ''new spending'' for programs in which the ''new spending'' provision applies. A couple of commenters also felt the proposed rule needed to be clarified. As a result of some of these comments, we have made some clarifications in the final rule, including revisions to reflect the statutory language more directly regarding the treatment of current fiscal year expenditures in any State or local program that also existed in FY 1995.

Comment: One commenter observed that this section indicates that expenditures made under separate State programs that had not previously been authorized under the former AFDC/EA/JOBS programs cannot now count toward maintenance of effort. The commenter objected to this provision. For example, the AFDC–UP program has been repealed. Therefore, families who previously received general assistance because a parent could not meet the criteria under the AFDC–UP program, now become ''part of the service equation.'' Therefore, the commenter suggested that all funds now spent to support these families should count for basic MOE purposes without limitation.

Response: The example given clearly falls under the statutory exception at section 409(a)(7)(B)(i)(II)(aa) of the Act. For programs that were operating in 1995 and were not former AFDC-related programs, States may only claim qualified expenditures with respect to eligible families if their expenditures are in excess of what they spent on that program in 1995. General assistance programs are not AFDC-related programs. AFDC-related programs include the AFDC, EA, and JOBS programs, as well as the IV–A child care programs (AFDC, At-Risk, and transitional child care programs). Qualified expenditures during a fiscal year to provide AFDC-related services (e.g., At-Risk Child Care services) to eligible families may count without limitation.

Comment: One commenter noted that for pre-existing programs (State or local programs operating in FY 1995) that were not AFDC-related programs, the State may only claim qualified State expenditures in the current fiscal year that exceed what the State spent on that program in FY 1995. Thus, State spending for State or local programs that are not AFDC-related must be ''new spending.'' However, in many cases, States will use both State MOE resources and Federal TANF funds to fund a number of different programs. The ''new spending'' provision could apply for these situations as well.

Response: We agree with this observation. Section 409(a)(7)(B)(II) of the Act excludes expenditures under ''any State or local program during a fiscal year'' that do not exceed the amount expended under the State or local program in FY 1995. Thus, the statute does not specify that the ''new spending'' provision on qualified State expenditures only applies to State programs that are currently separate from TANF. Instead, the provision applies to ''any'' State or local program existing in FY 1995 that did not have allowable expenditures under the former AFDC, EA, JOBS, and IV–A child care programs (AFDC, At-Risk and transitional child care programs). For example, a State or local program that is now included under the TANF program or receiving TANF and MOE resources could have existed separately from the State's former AFDC-related programs in FY 1995. Therefore, we have decided to amend the annual report to require that States report the information proposed under § 273.7(b) for all their State-funded MOE programs. We refer you to § 265.9 for a full discussion of all the comments regarding the proposed annual addendum and the changes we have made in the final rule.

Comment: One commenter noted that State spending in a State At-Risk Child Care program is an example of spending that was previously authorized and allowable under former section 403. Therefore, the ''new spending'' provision does not apply. Another commenter wondered whether expenditures for which a State could not have received Federal matching payments due to the At-Risk cap would also be exempt from the ''new spending'' provision. For example, take the case of a State that has run an At-Risk Child Care program for the working poor since FY 1995. The State did not receive matching funds for all of its expenditures for child care services under this program. Are the potentially qualified expenditures above the former cap subject to the ''new spending'' provision or exempt from this provision?

Response: If the State's child care program for the working poor was authorized and allowable under former section 402(i) under the Act, then we believe the ''new spending'' provision would not apply to qualified expenditures with respect to eligible families during a fiscal year, for the reasons given below.

Former section 402(i)(5) of the Act specified that amounts expended by the State to provide child care to any at-risk low income family would be matched. However, section 403(n) limited the amount of the matching payments a State could receive. The issue is whether a State can count all of its qualified expenditures with respect to eligible families during a fiscal year, without limitation, because the expenditures in FY 1995 were allowable, notwithstanding the cap.

Section 409(a)(7(B)(II)(bb) of the Act uses the phrase ''is entitled to a payment'' under former section 403 to indicate when the ''new spending'' provision does not apply. After considerable deliberation on this issue, we concluded that Congress intended States to be able to claim the State's portion of title IV–A welfare spending toward basic MOE, based on the idea that MOE is a substitute for the former matching arrangement. To carry out this intent, Congress needed to define the former title IV–A welfare spending. They did this by referring to

expenditures for which the State would be entitled to payment under former 403 of the Act. This section authorized Federal matching payments for allowable welfare expenditures. Thus, we believe that Congress was looking for allowable welfare expenditures, not actual payments to the States. This concept would include allowable expenditures that were more than the State could receive in the form of a matched payment. Therefore, we conclude that the new spending provision does not apply to child care expenditures made by a State to augment the Federal and State matching funds available in its At-Risk Child Care program.

However, we remind States of the dollar limitation discussed under § 263.3 of this subpart. Qualified child care expenditures used to meet the requirements of the CCDF matching fund (i.e., as matching and MOE amounts) may also count as basic MOE expenditures only up to the State's child care MOE amount.

Comment: One commenter raised questions about the appropriate calculation for determining the amount of new spending for programs subject to this provision. The commenter noted that it is not clear from the statute if the intent of this provision is for States to only count toward the MOE requirement additional spending that represents an increase over FY 1995 spending levels on eligible families. If this is the statutory intent, then the commenter recommends that we require a State to document whether its spending above FY 1995 levels has served eligible families and to report spending on eligible families in FY 1995. In cases where the State does not know the precise level of FY 1995 spending on eligible families, the regulations should permit States to use a reasonable estimating methodology. If the State is unable to determine or to estimate the amount of spending on eligible families in FY 1995, then it would need to otherwise demonstrate that it has targeted all of the increase in spending (relative to FY 1995 funding levels) toward eligible families.

In addition, the commenter recommends that we require total FY 1995 State expenditures for all State or local programs subject to the new spending provision, not just separate State programs as we proposed. Thus, the commenter believed that we should require this information for State or local programs funded with both TANF, as well as MOE resources. We should also require total State spending in the same State or local program for the current fiscal year. Otherwise, we will be unable to determine whether claimed MOE expenditures meet the new spending provision.

Response: Although the commenter was responding to our proposal under § 273.7(b) to collect supplementary information on separate State programs, we believe that this is the best place to address the commenter's points because they speak to the calculation of additional or new spending claimed for MOE purposes. However, we also refer you to § 265.9 for a fuller discussion of all the comments regarding the proposed annual addendum and the changes we have made in the final rule to the information States must report annually.

We do not agree that it is either necessary or required in the statute for a State to document or to report to us what it spent during FY 1995 on eligible families in programs that are now subject to the ''new spending'' provision. The ''new spending'' provision under section 409(a)(7)(B)(II)(aa) of the Act references current fiscal year expenditures under any State or local program to the extent that ''the expenditures exceed the amount expended under the State or local program'' in FY 1995.

This provision does not refer to eligible families in defining ''the amount expended'' in FY 1995; rather it refers generally to expenditures. However, it does refer to eligible families in defining qualified expenditures for the current fiscal year. As a result, we conclude that States must calculate ''new'' or additional spending under each State or local program subject to the ''new spending'' provision by comparing total qualified State expenditures with respect to eligible families for the current fiscal year with total State expenditures for the program in FY 1995. If total qualified State expenditures with respect to eligible families for the current fiscal year exceed total State expenditures in FY 1995 under the program, the State may claim the excess for basic MOE purposes because the State spent all those funds on eligible families. If total qualified State expenditures with respect to eligible families for the current fiscal year do not exceed total State expenditures in FY 1995 under the program, the State may not claim any current fiscal year qualified expenditures toward its basic MOE requirement.

We agree with the commenter's suggestion that a State should report total FY 1995 expenditures for each State or local MOE programs subject to the ''new spending'' provision. We are also requiring total current fiscal year expenditures for all State or local MOE programs. This includes State or local MOE programs that are currently separate from the State's TANF program, as well as MOE programs funded under TANF. We are requiring this information because it will help provide context for the reported expenditures on eligible families and give some indication of their plausibility.

Section 263.6—What Kinds of Expenditures Do Not Count? (§ 273.6 of the NPRM)

Overview

As we previously discussed, expenditures under State programs (TANF and separate State programs) do not count as MOE if they are not made on behalf of eligible families.

The statute also provides several general restrictions on MOE expenditures. Pursuant to section 409(a)(7)(B)(iv), the following types of expenditures do not count: (1) expenditures of funds that originated with the Federal government; (2) State funds expended for the Medicaid program under title XIX of the Act; (3) any State funds used to match Federal WtW funds provided under section 403(a)(5) of the Act, as amended by sections 5001(a) (1) and (2) of Pub. L. 105–33; and (4) expenditures that States make as a condition of receiving Federal funds under other programs. See discussion of § 263.3 for additional information.

Section 5506(c) of Pub. L. 105–33 amended section 409(a)(7)(B)(i) by adding another restriction under section 409(a)(7)(B)(i)(III). Pursuant to section 409(a)(12), States must expend State funds equal to the total reduction in the State's SFAG due to any penalties incurred. Section 409(a)(7)(B)(i)(III) provides that such expenditures may not count toward a State's basic MOE. (See § 264.50.)

TANF funds transferred to the Social Service Block Grant Program, under title XX of the Act, or transferred to the Child Care and Development Block Grant program (also known as the Discretionary Fund within the Child Care and Development Fund), do not count toward meeting a State's MOE requirement because of the first restriction under 409(a)(7)(b)(iv), which prohibits funds that originated from the Federal government from being used for MOE purposes.

Finally, it is important to note that only State expenditures made in the fiscal year for which TANF funds are awarded count toward meeting the MOE requirement for that year. For example,

expenditures made in prior fiscal years or, in the case of FY 1997, expenditures made prior to the date the State started its TANF program do not count as basic MOE.

Comments and Responses

We received few comments on this section, including a comment concurring that this section accurately tracks statutory requirements. Although no changes need to be made to the final rule as a result of these comments, we are clarifying § 263.6(b) of the final rule so that the regulatory language aligns more closely with the statutory prohibitions at section 409(a)(7), as amended.

Specifically, the proposed rule at § 273.6(b) provided that State funds used to match Federal funds (or expenditures of State funds that support claims for Federal matching funds), including State expenditures under the Medicaid program, do not count toward a State's basic MOE requirement. We have kept the part of this provision that prohibits State funds expended for the Medicaid program under title XIX from counting toward a State's basic MOE requirement. The rest of this provision is included in § 263.6(c).

If it had remained part of paragraph (b), then it would have been misleading and would have contradicted the exception under § 263.6(c). That exception permits State funds expended to meet the requirements of the CCDF Matching fund to count (up to the State's child care MOE level) toward the State's basic MOE requirement, provided the State has met all other requirements of this subpart. The requirements of the CCDF Matching Fund include an MOE requirement plus additional State expenditures that would be matched with Federal funds, up to the State's allocation. Based on the proposed wording under paragraph (b) of this section, the additional child care expenditures made by the State for purposes of receiving matching funds would not have counted toward the State's basic MOE. Yet, we stated clearly under paragraph (c) of this section and in the proposed § 273.3(a) that such child care expenditures could count (up to the amount of the State's child care MOE level).

We believe that the prohibition under revised § 263.6(c) takes in all requirements that a State must meet to receive Federal TANF funds, whether it is an MOE requirement, expenditures to receive Federal matching funds, or both. In addition, the Balanced Budget Amendments (Pub. L. 105–33) amended section 409(a)(7)(B)(iv) by replacing the prohibition under (III) ''any State funds which are used to match Federal funds'' with the prohibition related to the receipt of WtW funds—namely, ''any State funds which are used to match federal funds provided under section 403(a)(5).'' We had not reflected this change in the language at § 273.6(b).

We conclude that the language at section 409(a)(7)(B)(iv)(IV) of the Act also prohibits the counting for basic MOE purposes of any State funds expended to match Federal funds under other programs (or expenditures of State funds that support claims for Federal matching funds). Therefore, this language did not need to appear in § 263.6(b) because the regulatory provision at § 263.6(c) incorporates this prohibition. When we deleted the language from § 263.6(b), we also removed the apparent contradiction between § 263.6 (b) and (c) regarding State child care expenditures used to meet the CCDF matching fund requirements.

Comment: One commenter recommended allowing encumbrances as of September 30th of a fiscal year, but paid in a subsequent period, to count toward the State's basic MOE requirement.

Response: We disagree with this recommendation. By statute, only expenditures count toward a State's basic MOE requirement. An obligation, or encumbrance, is not an expenditure until actually paid. An expenditure counts toward the State's annual basic MOE requirement for the fiscal year in which it is actually paid.

Comment: One commenter believes that any expenditures made to replace reductions in the SFAG as a result of penalties should count toward the State's basic MOE requirement.

Response: The statute at 409(a)(7)(B)(i)(III) expressly excludes these additional State expenditures from counting toward the State's basic MOE requirement.

Comment: One commenter was concerned that States may infer that the prohibition on counting any State funds used as a condition of receiving Federal funds under another Federal program means that States may not purchase bus passes for program participants or otherwise help pay for their public transportation because, then, TANF resources are going to public transit providers who use the money as a match for their own Federal grants.

Response: Section 409(a)(7)(B)(iv)(IV) of the Act and § 263.6(c) of the regulatory text prohibit counting for basic MOE purposes any State funds that are expended as a condition of receiving Federal funds from other programs (unless specifically authorized, e.g., the State child care expenditures under the CCDF matching fund). For example, this prohibition would apply to State funds expended to meet the cost-sharing requirement of the recently passed Jobs Access transportation grants program.

However, the purchase of bus passes, in the context described by the commenter, does not constitute an example of State funds spent in order to receive other Federal funds. Rather, it represents an alternative form of providing a transportation benefit for a TANF-eligible family. As previously discussed, State funds used to purchase bus passes that help an eligible family member go to or from work or training would be an appropriate use of State MOE funds because this activity promotes job preparation and work, a purpose of the TANF program.

Section 273.7 of the NPRM

Note: We moved the provisions that appeared in § 273.7 of the NPRM and have not issued a new § 263.7. The information proposed in § 273.7(a) and the comments on this section appear under § 265.3. The information proposed in § 273.7(b) and the comments on this section appear under § 265.9.

Section 263.8—What Happens If a State Fails To Meet the Basic MOE Requirement? (§ 273.8 of the NPRM)

Overview

Under section 409(a)(7)(A), if a State does not meet the basic MOE requirement, we will reduce the amount of the SFAG payable for the following fiscal year on a dollar-for-dollar basis.

Section 5001(g) of Pub. L. 105–33 added another penalty to section 409(a) for a State that receives a WtW formula grant pursuant to section 403(a)(5)(A) of the Act, but fails to meet the basic MOE requirement for the fiscal year. Under section 409(a)(13) of the Act, we must reduce the amount of the State's SFAG for the following fiscal year by the amount of the WtW formula grant paid to the State if the State fails to meet the basic MOE requirement.

Comments and Responses

We received three comments on this section. One commenter observed that this section tracks the statutory requirement. Two others commented on the severity of the penalty amounts. We have made no changes to this section.

Comment: Two commenters felt that the penalties are too severe. One commenter recommended deleting the provision that requires reducing the State's SFAG by the amount of a State's WtW grant if the State fails to meet its

basic MOE requirement for the fiscal year.

Response: Although we agree that the penalties are very significant, as we mentioned in the above discussion, the statute expressly requires both reductions.

Section 263.9—May a State Avoid a Penalty for Failing To Meet the Basic MOE Requirement Through Reasonable Cause or Corrective Compliance? (§ 273.9 of the NPRM)

Overview

Under section 409(b)(2), a State may not avoid a penalty for failure to meet its basic MOE requirement based on reasonable cause. In addition, section 5506(m) of Pub. L. 105–33 amended section 409(c)(4) to provide that a State may not avoid the penalty through a corrective compliance plan.

Congress' decision not to provide for a reasonable cause exception or corrective compliance in basic MOE penalty cases indicates that Congress considered the MOE requirement crucial to meeting the work and other objectives of the Act.

Comments and Responses

We received three comments on this section. One commenter agreed that this section tracked the statute. The other commenters basically questioned the lack of reasonable cause and corrective compliance. We have made no changes to this section.

Comment: Two commenters thought that reasonable cause and the corrective compliance process should be available to a State that failed to meet its basic MOE requirement. One of the commenters expressed concern that the regulations are silent with respect to an appeal process.

Response: As we mentioned in the above discussion, the statute under sections 409(b)(2) and 409(c)(4) of the Act expressly provides that reasonable cause and corrective compliance do not apply to the basic MOE penalty provision. The State may appeal our decision to impose a reduction on the SFAG payable to the Departmental Appeals Board, in accordance with section 410 of the Act. Hence, the appeal process described in § 262.7 applies even if reasonable cause and corrective compliance do not apply.

Subpart B—What Rules Apply to the Use of Federal TANF Funds?

Section 263.10—What Actions Would We Take Against a State if It Uses Federal TANF Funds in Violation of the Act? (§ 273.10 of the NPRM)

Overview

Section 409(a)(1) contains two penalties related to use of Federal TANF funds (i.e., all Federal TANF funds under section 403) in violation of TANF program requirements. The first is a penalty in the amount of funds that a State uses improperly, as found under the Single Audit Act. We would reduce the SFAG payable to the State for the immediately succeeding fiscal year quarter by the amount misused.

In addition, we would take a second penalty, equal to five percent of the adjusted SFAG, if we find that a State has intentionally misused funds. You can find criteria for ''intentional misuse'' at § 263.12.

For both of these penalties, States may request that we grant reasonable cause and submit a corrective compliance plan for correcting the violation.

We received no comments on this section. However, we did revise the regulatory text because we noticed that it did not closely track the statutory language. The final rule language is clearer that the five-percent penalty for intentional misuse of funds is in addition to the misuse-of-funds penalty. Also, like the statute (at section 409(a)(1)(B)), the final rule puts the burden of proof regarding intent on the State.

Section 263.11—What Uses of Federal TANF Funds Are Improper? (§ 273.11 of the NPRM)

Overview

The statute contains many prohibitions and restrictions on the use of Federal TANF funds. In determining if funds have been used ''in violation of this part,'' States should particularly note the prohibitions in section 408 of the Act and section 115 of PRWORA. In summary, these sections provide that States must not use Federal TANF funds to provide assistance to:

- A family with an adult who is a head-of-household or a spouse of a head-of-household or with a minor head-of-household who has received assistance funded with Federal TANF funds for more than 60 months (except for a family included in the 20-percent hardship exemption);
- A family without a minor child living with a parent or adult caretaker relative (or a pregnant individual);
- A family not assigning support rights;
- An unmarried parent under 18, without a high school diploma, who does not attend high school or equivalent training;
- An unmarried parent under 18 not living in an adult-supervised setting (unless covered by a statutory exception);
- A fugitive felon and probation and parole violator;
- A minor child absent from the home 45 days (or at State option, 30–180 days);
- For ten years, a person found to have fraudulently misrepresented residence to obtain assistance; and
- An individual convicted of certain drug-related offenses unless the State has enacted a law to exempt such individuals from the prohibition (refer to section 115 of PRWORA).

Also, States must not use Federal TANF funds for medical services, except for pre-pregnancy family planning services. (This prohibition raised a number of concerns among States and advocates that are discussed below.)

Section 404 also limits the use of Federal TANF funds. More specifically, section 404(a)(1) provides that TANF funds may only be used ''* * * in any manner that is reasonably calculated to accomplish the purpose of this part, including to provide low income households with assistance in meeting home heating and cooling costs. * * *'' Thus, TANF funds cannot be used in a manner not reasonably calculated to serve the purposes of the program.

In determining if an activity may be funded with TANF funds under this provision, you should refer to the purposes described in section 401 of the Act and reiterated at § 260.20. Also, you should be aware that the specific prohibitions or restrictions in the statute (e.g., the prohibitions in section 408) apply even if an activity seems otherwise consistent with the purposes in section 404(a)(1).

In addition, section 404(a)(2), as amended by section 5503 of Pub. L. 105–33, permits Federal TANF funds to be used ''in any manner that the State was authorized to use amounts received under part A or F, as such parts were in effect on September 30, 1995 or (at the option of the State) August 21, 1996.'' We interpret this provision to cover activities that are not permissible under section 404(a)(1), but were included in a State's approved State AFDC plan, JOBS plan, or Supportive Services Plan as of September 30, 1995, or, at State option, August 21, 1996. Examples of such activities are juvenile

justice and foster care activities that were included in many State plans. Under this provision, only those States whose approved AFDC State plans included juvenile justice activities as of September 30, 1995, or, at State option, August 21, 1996, may use Federal TANF funds for those activities.

Because of the detailed and specific legislative history associated with the language at section 404(a)(2), indicating Congress's clear intent to grandfather in juvenile justice costs as an allowable use of Federal TANF funds, we would allow such use, notwithstanding the specific prohibitions in section 408 of the Act (e.g., prohibiting the expenditure of Federal TANF funds on assistance if a child is not living with an adult relative).

States should also note that if they exceed the 15-percent limit on administrative costs under section 404(b), we will consider any amount of funds exceeding that limit to be a misuse of funds. In the final rule, we have modified the language in §§ 263.11 and 263.13 to clarify this position.

Likewise, we would consider unauthorized or inappropriate transfers of TANF funds to be a misuse of funds. We would consider any of the following transfers to be inappropriate or unauthorized: transfers to any program except the Child Care and Development Block Grant (also known as the Discretionary Fund within the Child Care and Development Fund) or the Social Services and Block Grant Program under title XX of the Social Security Act; transfers to those two programs in excess of the 30-percent cap; and transfers to SSBG in excess of the 10-percent cap (or, beginning in FY 2001, in excess of the 4.25-percent cap). TANF expenditures used to match Job Access funds are not considered transfers.

OMB Circulars A–102 and A–87 also include restrictions and prohibitions that limit the use of Federal TANF funds.

The Department previously promulgated A–102 (the common rule) in its regulations at part 92 of title 45, ''Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.'' All provisions in part 92 are applicable to the TANF program. TANF is not one of the Block Grant programs exempt from the requirements of part 92, as OMB has not taken action to exempt it. Rather, OMB has determined that TANF should be subject to part 92. Section 417 was not meant to invalidate other general requirements that Congress and Federal agencies, primarily OMB, have put in place to assure that Federal grant funds are properly administered or to inhibit Federal agencies from fulfilling their financial management responsibilities in managing their programs. We believe that Congress understood that TANF, like other Federal grant programs, was subject to existing appropriations, statutory, and regulatory requirements regarding the general administration of grants, notwithstanding section 417.

By reference, part 92 also includes A–87, the ''Cost Principles for State, Local and Indian Tribal Governments,'' the basic guidelines for Federal awards. These guidelines provide, in part, that an allowable cost must be necessary and reasonable for the proper and efficient administration of a Federal grant program, and authorized or not prohibited under State or local laws or regulations.

A–87 also includes some specific prohibitions on the use of Federal funds generally that apply to Federal TANF funds. For example, A–87 prohibits the use of Federal funds for alcoholic beverages, bad debts, and the salaries and expenses of the Office of the Governor.

(a) Clarifications of Use of Federal TANF Funds—Substance Abuse Services

In our pre-NPRM consultations, we received several inquiries regarding the use of Federal TANF funds for substance abuse treatment, i.e., treatment for alcohol and drug abuse. In light of the prohibition on the use of Federal TANF funds for ''medical services, except for pre-pregnancy family planning activities,'' we held discussions with other Federal agencies and learned that in many, but not all instances, the treatment of alcohol and drug abuse involves not just ''medical services,'' but other kinds of social and support services as well.

Allowing States to use Federal TANF funds for substance abuse treatment is programmatically sound and reasonably calculated to achieve TANF goals since it may help clients make successful transitions to work and provide for a stable home environment for TANF children. Accordingly, our rules permit States to use Federal TANF funds for drug and alcohol abuse treatment services to the extent that such services are not medical. States will have to look at the range of services offered and differentiate between those that are medical and those that are not. In short, States may not use Federal TANF funds for services that the State identifies as medical; they may only use Federal TANF funds for services that are nonmedical.

(b) Clarification of the Use of Federal TANF Funds for Construction and Purchase of Facilities

The Comptroller General of the United States has prohibited the use of Federal funds for the construction or purchase of facilities or buildings unless there is explicit statutory authority permitting Federal grant funds to be used for this purpose. Since the statute is silent on this matter, States must not use Federal TANF funds for construction or the purchase of facilities or buildings.

(c) Clarification of the Use of Federal TANF Funds as State Match for Other Federal Grant Programs

States may use Federal TANF funds under section 403(a) to match other Federal grant programs only if authorized under the statute of the grant program. Further, any funds so authorized are still subject to the TANF program requirements and must be used in accordance with the purposes of the TANF program and with these regulations.

(d) Clarification of the Use of Federal TANF Funds To Add to Program Income

We have received a number of inquiries about whether or not TANF funds may be used to generate program income. An example of program income is the income that a State earns if it sells another State a training curricula that it has developed, in whole or mostly, with Federal TANF funds.

States may generate program income to defray costs of the program. Under 45 CFR 92.25, there are several options for how to treat this program income. To give States flexibility in their use of TANF funds, States may add, to their TANF grant, program income that has been earned by the State. States must use such program income for the purposes of the TANF program and for allowable TANF activities. We will not require States to report on the amount of program income earned, but they must keep on file financial records on any program income earned and the purposes for which it is used, in the event of an audit or review.

(e) Clarification of the Use of Federal TANF Funds—Amounts Reserved for Subsequent Years

Section 404(e) of the Act, entitled ''Authority to Reserve Certain Amounts for Assistance,'' allows States to reserve Federal TANF funds that they receive ''for any fiscal year for the purpose of providing, without fiscal year limitation, assistance under the State program funded under this part.'' In the

NPRM preamble, we did not include a specific discussion of this provision. However, we have added a preamble discussion in the final rule because: (1) we have subsequently received questions about its interpretation; (2) the penalty on misuse of Federal funds encompasses this provision; and (3) the definition of assistance at § 260.31 has implications that States need to understand.

After a careful reading of section 404(e), we have determined that the statute limits a State's ability to spend reserved money in a couple of very important ways. First, a State may expend reserved money only on benefits that meet the definition of assistance at § 260.31 or on the administrative costs directly associated with providing such assistance. It may not expend reserved funds on benefits specifically excluded from the definition of assistance or on activities generally directed at serving the goals of the program, but outside the scope of the definition of assistance. Secondly, a State may spend its reserved funds only on assistance provided within its TANF program (i.e., ''the State program funded under this part''). This latter limitation precludes the State from transferring reserved funds to either the SSBG or the Discretionary Fund of the CCDF. We believe the effect of these limitations will not be too serious because States are still spending such large portions of their funds on benefits that meet the definition of assistance. However, to ensure themselves the maximum flexibility in the use of their funds, States could spend down their reserved funds on any expenditures on assistance and leave current-year funds available to cover transfers and other activities.

Comments and Responses

We received several comments on this section. A couple of commenters expressed concerns about a State's ability to correct information in their Financial Report, avoid penalties for minor reporting errors, and present a case that they should not be penalized; you can find a discussion of the issues in the preamble for § 265.8. A detailed discussion of the other comments on this section and our responses follows. These comments resulted in a couple of minor changes to the proposed policy.

Comment: Most comments received on this section addressed the prohibitions and restrictions on the use of Federal TANF funds. We received some general support for our proposals and clarifications (e.g., allowing for program income and clarifying that States could expend Federal TANF fund on nonmedical substance abuse services). We also received a number of individual comments seeking additional clarification or more detail in the regulation about the allowability of certain expenditures. Areas of concern to individual commenters were medical costs, substance abuse, transportation, and juvenile justice services.

Response: We think it is very important that we lay out for States our view of what would constitute a misuse of funds so that they will be in the best possible position to avoid this penalty. Basically, section 404(a)(1) provides that Federal TANF funds may be used ''* * * in any manner reasonably calculated to accomplish the purpose of this part. * * *'' However, section 408 of the Act and section 115 of PRWORA provide that States must not use Federal TANF funds in specified circumstances. In addition, section 404 limits the use of Federal TANF funds. The prohibitions in sections 408 of the Act and 115(a)(1) of PRWORA and the limitations in section 404 of the Act apply, even if an activity seems otherwise consistent with the purpose of this section.

Section 404(a)(2), as amended by section 5503 of Pub. L. 105–33, permits Federal TANF funds to be used ''in any manner that the State was authorized to use amounts received under part A or F, as such parts were in effect on September 30, 1995 or (at the option of the State) August 21, 1996.''

Activities authorized under this subsection must have been in an approved plan under part A or F to be an allowable expenditure of Federal TANF funds.

In response to commenters' concerns, we have added references to sections 404 and 408 of the Act to the regulatory text. These are the two most significant statutory references for TANF requirements that were not specified in the proposed regulatory text.

In general, we believe it is sufficient for our rules to provide broad references to the statutory, regulatory, and policy provisions that will apply under this penalty. In certain policy areas—including administrative costs, the applicability of general grant administration standards, and the allowability of previously authorized expenditures—we believe that some clarification was needed, and our preamble and regulations reflect that judgment. However, other statutory provisions (e.g., much of section 408 of the Act and section 115(a)(1) of PRWORA) are relatively straightforward, and we are not aware of significant issues of interpretation that necessitate further regulation of these provisions.

In response to some of the specific concerns raised by commenters, we point out the following:

(1) The allowability of juvenile justice services depends upon what was previously authorized under a State's plan. A Federal definition would not be appropriate.

(2) Because of the statutory prohibition on use of Federal TANF funds for medical expenditures (except for pre-pregnancy planning), we could not authorize employment-related medical expenditures or medical services for substance abuse treatment under regulation.

However, we have decided not to provide a definition of medical services (and other key terms) in order to give States the maximum flexibility to provide services needed by recipients—within the constraints of the statute.

(3) To the extent that we have not addressed a provision in this final regulation, States may expend their Federal TANF funds under their own reasonable interpretations of the statutory language, and that is the standard that will apply in determining penalty liability.

(4) In several respects, States have more flexibility in the use of Federal TANF funds than State MOE funds. Two of these are: (1) on benefits that were previously authorized; and (2) in certain circumstances, on benefits that serve the goals of the program, but are not attributable to individual needy (or eligible) families. For example, if the expenditures are reasonably related to the purposes of TANF (at § 260.20) and do not constitute expenditures for ''assistance'' (and are otherwise allowable), a State could use Federal TANF funds for transportation investments that reduce the dependence and support the employment of needy parents, even if it cannot associate all such expenditures with individual needy families. Likewise, States may use Federal TANF funds for expenditures associated with the third and fourth TANF goals (i.e., related to the formation and maintenance of two-parent families and the prevention of out-of-wedlock pregnancies) without associating such expenditures to individual needy families. Thus, the statute and rules both provide States with some of the spending flexibility that commenters were seeking, with respect to transportation expenses, in particular, and other types of activities.

Comment: We received a few comments concerning our reference to activities carried out under AFDC or JOBS. Commenters objected to our conception that section 404(a)(2) covered only those prior program

expenditures that were included in a State's AFDC or JOBS plans. Also, a couple of commenters wanted broad authority to spend funds on emergency services for children, such as juvenile justice, even when their State plans did not include specific references to such services.

Response: Section 404(a)(2) provides that a State may use its Federal TANF funds ''in any manner that the State was authorized to use amounts received under part A or F * * *'' Although more than one interpretation of this phrase is possible, we believe our interpretation is the best for a number of legal and policy reasons. First, the reference to ''the State'' in the statutory language is consistent with looking at each State individually based on what was specifically authorized for that State. Also, under prior law, costs were authorized based on approved State plans. Second, our interpretation is consistent with the view that section 404(a)(2) was designed to ''grandfather in'' States whose prior programs allowed such expenditures. Third, there were some questionable funding practices by States under prior law, and we believe the best policy is to limit the extent to which they are perpetuated.

Thus, in order for a State to expend Federal TANF funds under the authority of section 404(a)(2), the expenditures at issue must have been specifically authorized under that State's AFDC or JOBS plan. Section 404(a)(2) does not broadly authorize continued expenditures on vaguely defined, or undefined, programs; it merely authorizes the use of the TANF ''in a manner'' in which the State previously had the authority to expend AFDC and JOBS funds. States only had authority to expend AFDC and JOBS funds consistent with approved plans.

Comment: We received several comments challenging the applicability of 45 CFR part 92 and OMB Circulars A–87 and A–102 to the TANF program and a few comments challenging the reference to section 115 of PRWORA. Commenters cited section 417 of the Act and the reference in section 409(a)(1) to violations ''of this part'' as the basis for not applying these provisions to the TANF program.

Response: We disagree with these comments. With respect to the OMB requirements, we believe that TANF, like other Federal grant programs, is subject to Departmental grants administration regulations and OMB circulars. The only time Federal grant programs would not be subject to grant administration regulations or OMB circulars is when OMB exempts them. OMB has not exempted the TANF program from these requirements; thus, they apply to the TANF program.

Section 417 does not prevent us from applying the part 92 regulations to TANF because the referenced requirements are not developed to enforce substantive provisions under this part. Thus, our approach to this issue is consistent with the approach taken in § 260.35 and discussed in the preamble section entitled ''Recipient and Workplace Protections''; i.e., section 417 of the Act does not limit the applicability of other Federal laws and rules.

With respect to violations of section 115 of PRWORA, first, we are clarifying that our intent is to cover only violations of section 115(a)(1) under the misuse penalty. Thus, we would focus on whether States were expending Federal TANF funds on individuals who are ineligible for such assistance under Federal law. We would not monitor compliance with other provisions under section 115. To make this point clear, we have changed the regulatory reference from ''section 115'' to ''section 115(a)(1).'' Secondly, we would point out that section 417 does not limit our ability to hold States accountable for complying with section 115 of PRWORA. While we could, in theory, set up a different enforcement mechanism, such as a disallowance system, to cover violations of this provision, that would seem to be an unnecessary administrative complication; the misuse penalty would have a comparable financial effect and provides States with ample opportunity to appeal.

Comment: One commenter suggested a change in language to conform more closely to what the statute reads. The change would substitute the language of this section from ''reasonably related to the purposes of TANF'' with ''reasonably calculated to accomplish the purposes of TANF.''

Response: We agree with the comment and have made the change.

Section 263.12—How Will We Determine if a State Intentionally Misused Federal TANF Funds? (§ 273.12 of the NPRM)

Overview

As we discussed in the proposed rule, in determining if a State has intentionally misused funds, we will apply a ''reasonable person'' test; i.e., a State must demonstrate to our satisfaction that it spent its TANF funds for purposes that a reasonable person would consider to be within the purposes of the TANF program. We will also consider funds to be intentionally misused if there is documentation, such as Federal guidance or policy instructions, that precludes the use of funds for such purposes, or if the State misuses the funds after receiving notification from us that such use is not allowable.

Comments and Responses

We received a few comments on this section. These comments resulted in a minor change to the proposed rule as discussed below. We also made some minor editorial changes to the regulatory text.

Comment: We received a number of comments about the procedures that applied to this penalty. Some commenters wanted the regulation to mention explicitly that the corrective compliance and appeal processes applied to the intentional misuse penalty. A few of these commenters also stated that we should give States an opportunity to submit a corrected financial report. One commenter further mentioned that States need a reasonable period of time to act upon a notification of misuse.

Response: Under the provisions of §§ 262.4, 262.5, 262.6, and 262.7 of the final rules, States have the opportunity to appeal a penalty based on the misuse or intentional misuse of funds. States have 60 days to submit a written response to our notification that we have determined it is subject to a penalty. We believe that 60 days is a reasonable period for a State to respond to a notification of misuse, as it is the amount of time the statute gives for submitting a corrective compliance plan and, under the audit process, a State should receive advance warning that the notification is coming. During this 60-day period, the State has the opportunity to demonstrate that our determination was incorrect or based on insufficient information. For example, a State could argue that the action at issue occurred prior to the effective date of final rules and was based on a reasonable interpretation of the statute. A State could also submit a corrected TANF Financial Report that helps demonstrate that all of its TANF expenditures were appropriate and allowable. In addition, as § 263.10 indicates, a State could demonstrate that it had reasonable cause for the misuse or intentional misuse of funds or provide us with a corrective compliance plan.

Comment: One commenter said that the misuse penalty should not apply while the State is pursuing legal remedies.

Response: We will not take an adverse action (i.e., reduce the adjusted SFAG)

prior to completion of any administrative review by the Departmental Grant Appeals Board (GAB). However, if the GAB sustains our penalty decision, the State will owe interest from the date of our final notification of an adverse action.

Comment: One commenter objected to the presumption in the NPRM that a State has misused funds until the State proves otherwise. The commenter argued that the proposed rule shifts the burden of proof to the States in proving a negative.

Response: We disagree with the comment. A State will normally receive notification that it has misused funds based on documented findings of audits performed under the Single Audit Act. As States know from prior experience, these audits utilize a variety of tools to evaluate expenditures, including the statute and regulations and a compliance supplement issued by OMB that focuses on certain areas of concern. In addition, the audit findings reflect reliable information taken from various sources, such as samples of case records and operational assessments. We believe that these audits will give us an objective appraisal of whether a misuse of funds has occurred.

Thus, we believe that the initial ''burden'' of establishing misuse of funds rests with the auditors rather than the State. Then, States will have the opportunity both to review, analyze, and rebut the findings via the standard audit resolution procedures and to seek penalty relief through the reasonable cause and corrective compliance processes.

Comment: A few commenters raised issues pertaining to misuse due to a failure to follow Federal guidance. One commenter mentioned that Federal guidance must be in accordance with the TANF statute before such guidance can be used to substantiate a claim of misuse. A second commenter recognized that legitimate issues may arise over a difference in interpretation of the statute. A third commenter argued that posting Federal guidance to a web page does not constitute notice and that States should be given adequate time to implement any changes necessitated by the guidance.

Response: We agree that Federal guidance must adhere to the statute. Currently, all guidance that we issue is based on a careful review of the statutory language and legislative history. We will continue to follow this practice when preparing future guidance.

We further recognize that a difference in the interpretation of a statutory provision is possible. We do not intend to penalize States pending resolution of such a difference. Under § 262.4, a State has the opportunity to demonstrate that our determination that the State is subject to a penalty was incorrect. In short, a State may present alternative interpretations of a statutory provision during the penalty resolution process. Because we could withdraw a determination of misuse based upon such a State presentation, we have changed § 263.12(b) and (c) to say that we ''may'' (rather than ''will'') consider funds to be misused if: (1) there is Federal guidance or policy indicating that TANF funds could not be used for a particular purpose; or (2) if the State continues to use the funds in the same or similarly improper manner after receiving notification of improper use.

Regarding the comment about notice of Federal guidance, we intend to rely on different methods for transmitting guidance to the States and other interested parties. We presently post Federal guidance to our web page and also mail it to all State TANF agencies and other appropriate parties. We plan to continue this dual issuance process so long as some State TANF agencies have limited Internet capabilities. However, in the interest of reducing costs associated with the printing and mailing of guidance materials, we intend to increase our reliance on electronic modes of communication as State capabilities increase. Also, we are sensitive to operational issues and, where possible, will include implementation time frames in our guidance.

Comment: A couple of commenters urged us to hold States accountable for complying with their plans for services and benefits under TANF and penalize States when they fail to do so.

Response: We do not believe that we have the authority under the statute to penalize States in these circumstances. The misuse of funds penalty refers to violations ''of this part.'' It does not reference expenditures made in violation of State plan provisions. Section 417 of the Act limits our ability to enforce TANF. Therefore, we have not included this recommendation in the final rule.

Section 263.13—Is There a Limit on the Amount of Federal TANF Funds a State May Spend on Administrative Costs? (§ 273.13 of the NPRM)

Overview

In the preamble for § 263.0, we discuss most of the comments we received on the administrative cost provisions in the rule. We decided to consolidate the discussion in one place since most of the comments related to both the Federal and the MOE cap. Therefore, we refer you to that section for a discussion of a host of issues related to the Federal cap.

This section of the rule speaks specifically to how the Federal administrative cost cap is determined. However, in reviewing the comments, we realized that the proposed rule had not directly presented the cap provision. To address this deficiency, we changed the title for this section and added a new paragraph (a) to explain the Federal cap provision. Paragraph (b) contains language from the NPRM on the exclusion for systems costs, modified as discussed below.

In paragraph (a), we also have added regulatory language advising States that we would consider a violation of the Federal cap to be a misuse of funds.

In reviewing the comments on the systems exclusion, we noted that proposed regulatory language in this section was not completely consistent with the statutory language (i.e., the proposed regulation said that the specified systems costs ''are not administrative costs for this purpose''). In the final rule, we have revised the language to conform more closely to the statute. Under the revised language, we track the statutory language and provide that the Federal administrative cost cap does not apply to ''Federal TANF expenditures on information technology and computerization needed for tracking or monitoring required by or under title IV–A of the Act.''

The revised regulatory language also provides clarification of one issue that was not directly addressed in the written comments, but which has come up in the context of the WtW regulation and the proposed rule on the bonus for reduction of out-of-wedlock births. By statute, the Federal administrative cap applies to any grant made to the State under section 403. It thus applies to WtW funds, out-of-wedlock bonuses, high performance bonuses, supplemental grants, high performance bonuses, and contingency funds.

The WtW regulations address the cap as it pertains to any WtW funds received by the State under section 403(a)(5). This final rule addresses any other funds provided under section 403.

The new language provides for a consolidated cap for all TANF funds (i.e., funds provided under section 403 other than WtW funds under section 403(a)(5)). Thus, it would limit the total amount of expenditures that a State could spend on administrative costs from all these separate funding provisions. We would not require that

the State meet a 15-percent cap for each of these multiple sources of funds.

While the statutory language would allow an alternative interpretation of separate funding caps, there is no evidence that Congress intended to create all these separate administrative cost caps. Also, we do not think creation of a consolidated cap would undermine the purpose of the provision, of limiting administrative costs, and we do not believe the potential benefit of separate caps would justify the additional administrative burden that States would incur.

Subpart C—What Rules Apply to Individual Development Accounts?

Section 263.20—What Definitions Apply to Individual Development Accounts (IDAs)? (§ 273.20 of the NPRM)

Overview

Individual Development Accounts (IDAs) are similar to savings accounts and enable recipients to save for ''big ticket'' items, such as a home, or a college education or start a business. Money in an IDA account would not affect a recipient's eligibility for TANF assistance.

States may use IDAs as an incentive for recipients to find jobs and to use their earned income to save for the future.

Recipients can use IDAs as long-term investments, without losing eligibility for TANF assistance in the early stages of becoming self-sufficient.

The NPRM defined an IDA as an account established by, or for, an individual who is eligible for TANF assistance to allow the individual to accumulate funds for specific purposes. It also defined a number of other terms used applicable to IDAs.

Comments and Responses

We received a few comments on the provisions in this section and made some minor changes to the proposed regulations, as discussed below.

Comment: Several commenters said that we should clarify whether individuals eligible for TANF assistance through segregated State funds could be beneficiaries of the IDA program.

Response: Under the definition in the NPRM, individuals who were eligible for TANF assistance could participate in IDAs.

The statute at section 404(h)(2)(A) provides that under a State program, an IDA may be established by or for an ''individual eligible for assistance under the State program operated under this part.'' This latter phrase means that IDAs can cover individuals who are eligible under the TANF program, regardless of the funding source. We have revised the regulatory language at § 263.20 so that it refers to eligibility for the TANF program. Under the definitions at § 260.30, the TANF program includes all activities under the State program, regardless of funding source.

Comment: One commenter stated that Federal regulations ought to expressly state that, under PRWORA, funds in an IDA are to be disregarded for purposes of determining eligibility for, or amount of, assistance under Federal means-tested programs (other than under the Internal Revenue Code).

Response: We agree that the regulations should clarify that States must disregard IDA funds in determining eligibility and amount of assistance for such Federal means-tested programs. Section 404(h)(4) explicitly states that there should be no reduction in benefits. We have revised the regulatory language at § 263.20 to clarify this point.

Comment: One commenter explained how one State defined its IDA programs under its welfare reform waiver more broadly than the NPRM and suggested that we revise the regulation to allow for a broader range of IDA strategies.

Response: The statute is very specific in terms of how IDA funds may be used. Accordingly, we have not changed the position taken in the proposed rule. However, under section 415 of the Act, until a State's welfare reform waivers expire, the State has latitude to continue its waiver policies and operate its program more broadly than the statute permits.

Section 263.21—May a State Use the TANF Grant To Fund IDAs? (§ 273.21 of the NPRM)

Overview

PRWORA gives States the option to fund an Individual Development Account Program. Thus, States have the option to fund IDAs with TANF funds for individuals who are eligible for TANF assistance.

We received one comment on the provisions in this section and made some minor changes to the proposed regulation, as discussed below.

Comment and Response

Comment: One commenter said that the NPRM does not clearly express that IDA is an optional program that the States may choose to implement within limits permitted by Federal law.

Response: We agree that the IDA provision is an optional program, which is subject to State rules within the limits permitted by Federal regulations and statute. We have revised the regulatory language at § 263.2 to clarify this point. Also, consistent with the statutory language at section 403(a)(5)(C)(v), we have specified that WtW funds may also be used to fund these IDAs.

Section 263.22—Are There Any Restrictions on IDA Funds? (§ 273.22 of the NPRM)

Overview

IDAs are similar to savings accounts and enable recipients to save earned income for certain specified, significant items. IDAs contain special restrictions on who can match recipient contributions.

The NPRM required that: (1) a recipient deposit only earned income into an IDA; (2) recipient's contributions to an IDA may be matched by a qualified entity; and (3) recipients may spend IDA funds only to purchase a home, pay for a college education, or start a business.

Comments and Responses

We received a few comments on the provisions in this section and made some minor changes to the proposed regulation, as discussed below.

Comment: Several commenters expressed that the NPRM was more restrictive than the statutory language on the source of matching funds and thereby unduly limited possible matching funds to an IDA account.

Response: The language in the proposed rule was inadvertently narrower than the statutory provision. We have changed the regulation at § 263.22 so it now comports with the statutory language. Under the final rule, ''matching funds may be provided by or through a qualified entity.''

Comment: One commenter stated that we should allow TANF recipients to withdraw money from IDAs for training expenses, as well as for post-secondary purposes.

Response: The statute is very specific in terms of how IDA funds may be used. Only post-secondary education expenses at an eligible institution are permissible. While expenses for certain vocational education or training activities would be allowable, expenses for job training that is not at the post-secondary level or at an eligible institution would not be. Accordingly, we have not changed the proposed rule.

Section 263.23—How Does a State Prevent a Recipient From Using the IDA Account for Unqualified Purposes? (§ 273.23 of the NPRM)

Overview

Money in an IDA account does not affect a recipient's eligibility for TANF assistance. Withdrawals from the IDA must be paid directly to a college or university, a bank, savings and loan institution, an individual selling a home, or a special account (if the recipient is starting a business).

Section 404(h)(2)(D) authorizes the Secretary to establish regulations to ensure that individuals do not withdraw funds held in an IDA except for one or more of the above qualified purposes.

In our research, we found that several States had established IDAs under their welfare reform demonstration projects and subsequently transferred those provisions to their TANF programs. Each State had designed its own procedures for preventing withdrawals or penalizing recipients who withdrew funds from their IDAs for unauthorized purposes. For example, several States count a withdrawal for a nonqualified purpose as earned income in the month of withdrawal unless the funds were already counted as earned income. Other States count such withdrawals against a family's resource limit. Still another State calculates a period of ineligibility using a complex formula.

With this in mind, we did not feel that it was necessary to be overly prescriptive in mandating how States would ensure that individuals do not make unauthorized withdrawals from IDA accounts. Thus, we give States broad flexibility to establish procedures that ensure that only qualified withdrawals are made.

In addition, section 404(h)(5)(D) gives the Secretary the authority to determine whether or not a business contravenes law or public policy. We have decided that we should base our determination on the business's compliance with State law or policies. Thus, our rules give States maximum flexibility in setting up these programs, while assuring that a business established by a needy family meets State requirements.

Comments and Responses

We received a few comments in support of the provisions in this section, as discussed below. These comments did not result in any change to the proposed policy or rule.

Comment: A few commenters supported the entire section on IDAs, noting that the Secretary exercised her discretion to give States maximum flexibility in designing and administering these programs.

Response: We appreciate the commenters' support for our approach. The intent of the proposed rule was to allow States the latitude that they needed to administer an effective IDA program and develop innovative approaches for moving recipients from dependency to self-sufficiency.

IX. Part 264—Other Accountability Provisions (Part 274 of the NPRM)

Note: We have moved the content of § 274.20 of the NPRM, entitled "What happens if a State sanctions a single parent of a child under six who cannot get needed child care?" to part 261. You can find a discussion of the comments related to this provision at §§ 261.15, 261.56 and 261.57.

Section 264.0—What Definitions Apply to This Part? (§ 274.0 of the NPRM)

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

We received no comments on this section. However, we decided to add definitions for "countable State expenditures," "Food Stamp trigger" and "unemployment trigger," which relate to the discussion of the Contingency Fund in subpart B, in order to make subpart B easier to understand. We also added a definition of "FAG," which is used in the discussion of the spending levels of the Territories in subpart C. Finally, we moved this section out of subpart A, as it was in the NPRM, so that it is clear that the definitions apply to this entire part.

Subpart A—What Specific Rules Apply for Other Program Penalties?

Section 264.1—What Restrictions Apply to the Length of Time Federal TANF Assistance May Be Provided? (§ 274.1 of the NPRM)

Under the former AFDC program, families could receive assistance as long as necessary, if they continued to meet program eligibility rules. Under the TANF program, Congress established a maximum length of time for which a family may receive assistance funded by Federal TANF funds.

Section 408(a)(7) stipulates that States may not use Federal TANF funds to provide assistance to a family that includes an adult who has received assistance for more than five years. We will calculate the five-year limit on Federal funding as a cumulative total of 60 months.

The legislative history for PRWORA clarifies the meaning of adult in section 408(a)(7)(A). States are to count only months for which an adult received assistance as the head-of-household or as the spouse of the head-of-household. (H.R. Rep. No. 725, 104th Cong., 2d sess., p. 288.) Generally, when a parent or other adult caretaker relative of a minor child applies for and receives federally funded assistance under the State's TANF program on behalf of himself or herself and his or her family, Federal funding of that assistance may not last longer than five years. States must disregard any months when an adult receives assistance when he or she is not the head-of-household or is not the spouse of the head-of-household.

Any month when a pregnant minor or minor parent received assistance as the head-of-household or married to the head-of-household counts toward the five-year limit. However, section 408(a)(7)(B) clarifies that the State must disregard any month for which assistance has been provided to an individual who is a minor child who is not the head of a household or married to the head of a household.

The five-year limitation on Federal funding also disregards any months that an adult receives assistance while living in Indian country (as defined by section 1151 of title 18, United States Code) or in an Alaska Native Village where at least 50 percent of the adults are not employed (see § 264.1(b)(1)(ii)).

Subsection 408(a)(7)(G) provides for special treatment of assistance provided to a family with Welfare-to-Work grant funds (formula or competitive) under the time-limit provision. First, months for which a family receives cash assistance funded with Welfare-to-Work grant funds (under section 403(a)(5) of the Act) do count towards the five-year limit; however, months for which a family receives only WtW noncash assistance do not count towards the five-year limit.

Second, families may receive assistance (cash or noncash) funded with WtW grant funds even though they are precluded from receiving other TANF assistance because of the five-year limit.

Some families may receive assistance from Federal TANF funds for more than five years based on hardship or if the family includes an individual who has been battered or subjected to extreme cruelty as defined in section 408(a)(7)(C)(iii).

Under section 408(a)(7)(C), the average monthly number of such families may not exceed 20 percent of the State's average monthly caseload during either that fiscal year or the immediately preceding fiscal year, whichever the State elects. We will not make a determination of whether a State has exceeded the cap until any families in the TANF program have received at

least 60 cumulative months of federally funded assistance.

Since the purpose of the provision is to provide an extension to the 60-month limit, it applies after that limit is reached. We believe that this approach is the most straightforward and comports with Congressional intent that TANF assistance be provided on a temporary basis while a family becomes self-sufficient. Thus, Federal support would cease once a head-of-household or spouse of the head-of-household in the family has been assisted for 60 total months with Federal TANF funds unless the State chooses at that time to include the family in its 20-percent exception. However, the State may elect to use State funds to continue paying eligible families.

The five-year time limit applies to Federal funding; it does not set an upper bound on the amount of time a State could provide assistance to an individual family with State funds. Further, States are free to impose shorter time limits on the receipt of assistance under their programs. They are also free to allow receipt for longer periods if the assistance is paid from State funds or if the family meets the criteria the State has chosen for extension and fits with the 20-percent limit.

In the NPRM preamble to this section, we clarified the relationship between domestic violence waivers of the time limit permitted under the Family Violence Option at section 402(a)(7) and the limit on the exceptions to the Federal time limit at section 408(a)(7)(C)(ii). The key issue was whether the 20-percent limit on hardship exceptions included families of domestic violence victims.

Section 402(a)(7)(B) expressly refers to section 408(a)(7)(C)(iii) in applying the meaning of the term ''domestic violence'' to the Family Violence Option at section 402(a)(7)(A). Section 408(a)(7)(C)(iii) defines ''battered'' or ''subjected to extreme cruelty'' for purposes of describing families who may qualify for a hardship exemption at section 408(a)(7)(C)(i), and section 408(a)(7)(C)(ii) specifies a 20-percent limit on the exceptions to the time limit due to hardship. Based on the statutory language, we concluded that the number of families waived from the five-year time limit per section 402(a)(7) fell within the 20-percent ceiling established under section 408(a)(7)(C)(ii). However, we allowed a State to claim ''reasonable cause'' when its failure to meet the five-year limit could be attributed to its provision of federally recognized good cause domestic violence waivers. In the final rule, we have moved the provisions on domestic violence to a new subpart B of part 260. You can find our preamble discussion of these provisions and the comments on our proposed rules in the earlier discussion entitled ''Treatment of Domestic Violence Victims.''

As previously discussed, section 408(a)(7)(D) provides an exemption to the time limit on receipt of federally funded TANF assistance for families living in Indian country or in an Alaskan Native village. The months that a family, which includes an adult, lives in Indian country or in an Alaskan Native village, where at least 50 percent of the adults are not employed, do not count when determining whether the adult has received federally funded assistance for 60 cumulative months. In accordance with section 408(a)(7)(D), the percentage of adults who are not employed in a month will be determined by the State using the most reliable data available for the month, or for a period including the month.

In the earlier preamble discussion entitled ''Waivers,'' we discuss the impact of waivers granted under section 1115 of the Act on the five-year time limit. You will find the regulatory provisions in a new subpart C of part 260.

We received a number of comments on this section. We made some revisions to the regulations as noted in our responses to the comments below. We also amended the regulations to reflect the position that only months for which an adult received assistance as the head-of-household or as the spouse of the head-of-household count toward the five-year time limit.

Comment: A couple of commenters expressed their opposition to all time limits, and one commenter stated that the time limits will cause families to suffer.

Response: The time limit is an important aspect of welfare reform. It is meant to ensure that States and recipients place a clear priority on work, responsibility, and self-sufficiency. However, in a time-limited program, States must make sure that they offer adequate services so that families can successfully move from welfare to work.

Comment: A commenter asked whether the State should count towards the time limit any months when the adult is ineligible, but the rest of the family receives assistance.

Response: The only months that count toward the time limit are months when a family member who is the head-of-household or the spouse of the head-of-household receives assistance. Thus, for example, if the family is comprised of a mother and her infant, and the mother is not receiving TANF assistance because she is receiving SSI or because she is an ineligible alien, the months when only her child receives TANF assistance do not count toward the time limit.

Comment: Some commenters asked how the time limit applies when children receive assistance, but the caretaker relative does not.

Response: Assuming that, in this situation, the head-of-household and the spouse of the head-of-household are not receiving TANF assistance, the months when the children receive assistance do not count toward the time limit.

Comment: A few commenters asked whether months count toward the time limit when a family is subject to a full-family sanction.

Response: Any months when the State imposes a full-family sanction, and no one in the family is receiving TANF assistance, do not count towards the Federal time limit. Only months for which an adult or minor head-of-household or spouse of the head-of-household receive assistance count. However, if it wishes to, a State may count such months towards its State time limit.

Comment: Another commenter asked whether months count toward the time limit when one member of a family is sanctioned.

Response: If an adult is sanctioned, and no one who is the head-of-household or the spouse of the head-of-household is receiving TANF assistance, the Federal time limit does not apply. However, if the head-of-household or the spouse of the head-of-household continues to receive assistance while another individual is being sanctioned or the effect of the sanction is to reduce benefits to the family as a whole without denying assistance to any individual member of the family, the Federal time limit does apply.

If the State wishes to count the months when a sanction applies to a family, it may count such months toward its State time limit even if it cannot count them towards the Federal time limit.

Comment: A commenter asked how the time limit applies when a family begins to receive assistance mid-month or if the State provides assistance semi-monthly.

Response: Whenever a family receives any TANF assistance for a month, whether it covers a whole month's worth of assistance or is a partial payment, that month counts toward the Federal time limit unless the exceptions in § 264.1(b) apply.

Comment: Another commenter stated that we should inform a State if its

policies are improper or will lead to a penalty.

Response: When a State submits its TANF State plan, we review it to determine whether the plan is complete. We also identify potential problem areas and share our comments with the State. Thus, the more detail a State submits in its plan, the more feedback the State will receive on its policies and procedures. At the same time, we advise the State that our finding that the TANF plan is complete does not constitute our endorsement of State policies.

Comment: A commenter asked whether receipt of TANF assistance by a noncustodial parent would affect the custodial parent and the children.

Response: In order for an individual to receive TANF assistance as a noncustodial parent, a State must consider that parent to be a member of the family. Only the months for which a parent receives TANF assistance as the head-of-household or the spouse of the head-of-household count toward the time limit. As defined at § 260.30, a noncustodial parent cannot be the head-of-household, since he or she does not live in the same household as the child. Therefore, the months a noncustodial parent receives assistance would not count unless he or she is the spouse of the head of the household.

We note that an individual can have more than one status and the above answer applies only to an individual receiving assistance as a noncustodial parent. An individual who is the noncustodial parent of one TANF child, could also be the custodial parent of another TANF child or the head-of-household for another TANF case; if he or she receives assistance as part of such a second family, it would count towards that second family's time limit.

Comment: A commenter asked us to clarify when receipt of TANF assistance by a pregnant teen or a teen parent would count toward the five-year time limit.

Response: The months count when a pregnant teen or teen parent receives TANF assistance while he or she is the head-of-household or the spouse of the head-of-household.

Comment: Another commenter argued that the statute does not provide the authority for us to impose time limits on a minor head-of-household or minor spouse of a head-of-household who is not pregnant and is not a parent.

Response: The commenter is correct. The months for which a minor head-of-household or minor spouse of a head-of-household who is not pregnant and is not a parent receives TANF assistance do not count toward the time limit.

Comment: Commenters asked us to clarify when assistance provided under the Welfare-to-Work program counts toward the Federal time limit. One commenter expressed the opinion that WtW should not count. Another commenter asked us to define WtW cash and noncash assistance.

Response: Under the statute, noncash assistance provided under WtW never counts toward the Federal 60-month time limit. Months for which WtW cash assistance is received do count if the assistance is received by a member of the TANF family who is the head-of-household or the spouse of the head-of-household. However, individuals who have received 60 months of assistance may continue to receive WtW assistance and other benefits.

Because of the interest in this issue, we have included a definition of WtW cash assistance at a new § 260.31. See the preamble for that section for additional discussion of that definition.

As previously discussed, the policies on counting WtW and TANF assistance apply to noncustodial parents. Receipt of WtW cash assistance or TANF assistance by a noncustodial parent, in his or her status as a noncustodial parent, does not count against the time limit unless he or she is the spouse of the head-of-household. If the noncustodial parent is the spouse of the head-of-household and is included by the State in its definition of a TANF family, such parent's receipt of WtW cash assistance or TANF assistance does count against the time limit. However, if the noncustodial parent is not included in the State's definition of a TANF family (e.g., he is receiving assistance as part of another family), his receipt of WtW cash assistance does not count towards the Federal TANF time limit for the family composed of the custodial parent and their children in common.

Comment: A commenter asked whether months when assistance is received under a Tribal TANF program count toward the Federal five-year time limit.

Response: Months for which a family received assistance under an approved Tribal Family Assistance Plan count toward the five-year time limit under both State and Tribal TANF programs. Under the provisions of section 408(a)(7), the five-year limit applies to TANF assistance provided with Federal TANF funds under part A of title IV of the Act. This includes assistance provided by Tribal TANF programs. However, there is an exception under § 264.1(b)(1)(ii) for months when an adult lived in Indian country or Native Alaskan Village with high unemployment.

Comment: A commenter asked whether the clock stops while an individual is in drug treatment so that she will be job ready.

Response: The clock does not stop. The clock stops only because of the factors listed in § 264.1(b).

Comment: Another commenter asked whether a State can exempt from the time limit a family with old or disabled parents or caretakers.

Response: A family cannot be exempted from the time limit on this basis. Months when a family receives assistance can be disregarded only according to the factors listed in § 264.1(b). However, once the family has received assistance for 60 months, the State can continue to provide assistance on the basis of hardship. The State can also choose to provide assistance with State-only funds.

Comment: A number of commenters were opposed to our provisions that attempted to restrict a State from excluding families from the time limit by including child-only cases in its definition of family and diverting families to separate State programs. The commenters also opposed our proposal to require States to report on the number of families excluded.

Response: We agree that we should not limit a State's ability to determine which families they will serve under TANF and that we should not assume that a State is attempting to circumvent the statute. Accordingly, we have removed these provisions from the final rules. We also removed the requirement for separate reporting of child-only cases. You can find additional discussion on this issue in the earlier preamble discussion entitled ''Child-Only Cases.''

Comment: While one commenter agreed with our position in the NPRM, a number of commenters argued that States should be able to stop the clock for hardship or domestic violence, or because individuals in the family are unable to participate in work activities before the family has received assistance for 60 months.

Response: We do not believe that the statute envisions stopping the clock for hardship or for any reasons other than those listed in § 264.1(b). Section 408(a)(7)(C) of the Act exempts families from being terminated from TANF assistance once they reach the 60-month limit; it does not exempt them from accruing months toward the limit. The statute permits States to continue to provide assistance to families beyond the 60-month limit based on hardship or because a family member has been

subjected to battery or extreme cruelty. However, as we discussed in the preamble section entitled ''Treatment of Domestic Violence Victims,'' we have revised the final rules to recognize a broader array of good cause domestic violence waivers to extend the time limit in determining whether a State that exceeds the 20-percent limitation will receive penalty relief. Accordingly, States may be able to extend the time limits for additional families, including victims of domestic violence.

Comment: A commenter asked how the 20-percent hardship extension applies when a State has a shorter time limit than 60 months.

Response: A State with a shorter time limit can establish its own policies for extending assistance under its State time limit. The State can extend assistance beyond its (shorter) time limit based on hardship or for other reasons. However, if a State extends its time limit and continues to provide assistance to a family, the additional months count toward the Federal time limit as they ordinarily would.

Comment: Some commenters expressed the view that our provisions for how States' section 1115 waivers affect the time limit are confusing and improper.

Response: We have made some minor adjustments to these provisions. Please refer to subpart C of part 260 and the earlier preamble discussion entitled ''Waivers.''

Section 264.2—What Happens if a State Does Not Comply with the Five-Year Limit? (§ 274.2 of the NPRM)

Congress created the penalty under section 409(a)(9) to ensure that States comply with the five-year restriction on the receipt of federally funded TANF assistance. If we determine that a State has not complied with the five-year time limit during a fiscal year, then we will reduce the SFAG payable for the immediately succeeding fiscal year by five percent of the adjusted SFAG.

Five years is the maximum period of time permitted under the statute for families to receive federally funded TANF assistance. Therefore, the penalty under this section does not apply if the State exceeds any shorter time limits on the receipt of federally funded assistance that it may choose to impose. It also does not apply to any time limits on receipt of State-funded assistance or the receipt of noncash WtW assistance.

In defining the requirement, section 409(a)(9) refers to section 408(a)(7). This latter section identifies the circumstances under which assistance may be provided for longer than five years. It provides exceptions to the time-limit requirement for minors, hardship, or families living in Indian country or in an Alaskan Native village with adult unemployment above 50 percent. Therefore, we will take into account the exceptions described under paragraphs (B), (C), or (D) of section 408(a)(7) when deciding whether the State complied with the five-year time limitation. We will use the information required to be reported in part 265 to learn whether a State is complying with the five-year time restriction on the receipt of federally funded assistance.

We do not intend to hold States immediately accountable for knowing about and verifying all months of assistance received in other States, since we are aware that, in general, States' data processing systems are not currently capable of accomplishing interstate tracking of the number of months an individual has received TANF assistance.

We received a few comments on this section, as discussed below. We made only one minor editorial change to the regulations. This change clarifies that, if a State failed to comply with the time-limit requirements, in order to avoid a penalty, it must demonstrate to our satisfaction that it had reasonable cause, or it must correct or discontinue the violation under the provisions of an approved corrective compliance plan.

Comment: A couple of commenters asked for guidance on how States should count months when a family received assistance in another State. Other commenters asked us to regulate that States will not be held accountable for knowing about a family's receipt of TANF assistance in another State.

Response: Each State must keep track of the number of months it provides TANF assistance that count towards the Federal time limit. As part of its application process, a State should ask a family whether it has lived in any other States. If the family has, the new State should contact the other State(s) to find out whether the family received assistance that counts toward the Federal time limit. We expect a State to do its best to gather this information, but will not hold the State accountable if its information about what happened in another State is not accurate, as long as the State has made a good faith effort to gather complete and accurate information. We have decided not to include this specific guidance in the regulations because our expectations for State accountability will change over time as technology improves and the State's ability to do interstate tracking of families increases.

Comment: A commenter asked whether a State with a State time limit that is shorter than the Federal time limit would be penalized if it fails to meet the requirements of its State time limit.

Response: The penalty at § 262.1(a)(9) only applies if the State fails to meet the Federal five-year time limit.

Section 264.3—How Can a State Avoid a Penalty for Failure to Comply With the Five-Year Limit? (§ 274.3 of the NPRM)

In § 262.5, we include general circumstances under which we may find reasonable cause to waive potential penalties. We also will consider an additional factor in determining whether there is reasonable cause for failure to meet the five-year limit. The additional factor relates to a State's implementation of the Family Violence Option and its provision of temporary waivers of time limits, when necessary, for victims of domestic violence.

We will grant a State reasonable cause for failing to meet the 60-month time limit, if it adequately demonstrates that it has exceeded the 20-percent limitation on exceptions because it granted individuals federally recognized good cause domestic violence waivers pursuant to subpart B of part 260. To qualify for reasonable cause based on this factor, a State would have to show that, if families with such waivers were disregarded, the number of families that received assistance did not exceed 20 percent. A State must substantiate its case for all claims of reasonable cause.

You can find additional discussion of our domestic violence policies in the preamble section entitled ''Treatment of Domestic Violence Victims.''

We received a number of comments on this section and made changes to the regulations, as discussed below.

Comment: Several commenters asked us to permit States to claim reasonable cause based on additional factors, such as the State's good faith effort to comply with the time limit, a hard-to-serve population, high unemployment or other adverse economic conditions, and other factors that are beyond the control of the State.

Response: As we discussed in the preamble to § 262.5, we believe it is sounder policy to encourage a State to correct problems and find solutions than to excuse a State's inability to meet the statutory requirements. Accordingly, we are not adding reasonable cause factors that we will consider if a State fails to meet the time-limit requirement of the statute. (However, we have revised the language at § 262.5 to allow more discretion to grant reasonable cause when a State faces special, unforeseen circumstances.)

Comment: A number of commenters also argued that we should not link the reasonable cause factor for federally recognized good cause domestic violence waivers to the victim's ability to work and that other changes should be made to the provision.

Response: We have addressed these comments in subpart B of part 260 and the preamble discussion entitled ''Treatment of Domestic Violence Victims.''

Section 264.10—Must States Do Computer Matching of Data Records Under IEVS To Verify Recipient Information? (§ 274.10 of the NPRM)

Congress originally established the Income and Eligibility Verification System (IEVS) in 1984 under section 1137 of the Act. PRWORA created a penalty at section 409(a)(4), requiring the reduction of a State's SFAG for the immediately succeeding fiscal year by up to two percent if a State is not participating in IEVS.

The IEVS provision was intended to improve the accuracy of eligibility determinations and grant computations for the public assistance programs (AFDC, Medicaid, Food Stamp and SSI). It achieves this goal by expanding access to, and exchanges of, available computer files to verify client-reported earned and unearned income. Specifically, it makes the following files available to the State public assistance agencies: (1) IRS unearned income; (2) State Wage Information Collection Agencies (SWICA) employer quarterly reports of income and unemployment insurance benefit payments; (3) IRS earned income maintained by the Social Security Administration (SSA); and (4) with the passage of the Immigration Control and Reform Act of 1986, immigration status information maintained by the Immigration and Naturalization Service (INS).

Currently, regulations at §§ 205.51 through 205.62 and the statute at section 1137(d) describe what is meant by ''participating * * * in the income and eligibility verification system required by section 1137.'' The regulation at § 205.60(a) requires each State to maintain statistics on its use of IEVS. In general, ''participation'' means that a State agency submits electronic requests to IRS, SWICA, SSA and INS for information listed in the preceding paragraph, for all TANF applicants and recipients. IRS, SWICA, SSA and INS provide the State agencies with an electronic response regarding the information requested. The frequency of the request and the timeliness of the response is a function of the data processing systems design of the responding agency. The State agency worker compares the information in the response to determine the accuracy of client reporting of case circumstances.

We received comments from two parties, which did not result in any changes to the regulation. However, we did make a change based on our internal review. INS has stated its view that Federal departments are no longer authorized to grant waivers to States to exempt certain programs from verifying alien eligibility through the SAVE system. (See 63 FR 41662, August 4, 1998.) Therefore, we removed the parenthetical in the proposed rule at paragraph (a)(4) referencing such waivers.

One of the commenters expressed the view that the proposed rule is consistent with the TANF statutory provisions. We discuss the other comments and our responses below.

Comment: A commenter argued that requiring data matches for all TANF applicants and recipients is not cost effective and should not be performed.

Response: The statute at section 1137 and the implementing regulations at §§ 205.51 through 205.62 provide that the State must request data matches for the entire TANF caseload.

Comment: The commenter asked whether we would permit targeting procedures for data matches based on cost effectiveness.

Response: States may use targeting procedures that govern the use of data matches. Paragraph 1137(a)(4)(C) of the Act states, ''The use of such information shall be targeted to those uses that are most likely to be productive in identifying and preventing ineligibility and incorrect payments, and no State shall be required to use such information to verify the eligibility for all recipients.'' The implementing regulation at § 205.56(a)(1) continues to permit States to exclude categories of information from a follow-up review. States perform reviews after the data matches and compare information obtained from the match with the case record to determine if it affects an applicant's or recipient's eligibility or the amount of payment.

Comment: The commenter also expressed disagreement with the definition of participation for ''all TANF applicants and recipients'' (e.g., naturalized citizens do not require a match with INS).

Response: We recognize that States are not required to perform a data match with the Immigration and Naturalization Service (INS) for naturalized citizens. The data match with INS is only required for alien applicants and recipients.

Section 264.11—How Much Is the Penalty for Not Participating in IEVS? (§ 274.11 of the NPRM)

Since IEVS has been in existence for more than 12 years, we believe that States have had sufficient time to become full participants in IEVS. Therefore, we will impose the maximum two-percent penalty upon all findings that a State is not participating in IEVS.

We will use an audit pursuant to the Single Audit Act as the primary means of monitoring a State's IEVS participation. We will also use statistics maintained by the State, as required by § 205.60(a), as another source of information and may conduct additional Federal reviews or audits as needed.

We received few comments on this section. We discuss the comments and our responses below. We made no changes to the regulations.

Comment: A few commenters expressed concern that we were not clear in the proposed rule about how we will determine a State's nonparticipation in IEVS and the amount of the penalty. Another commenter argued that the amount of the penalty in proposed regulation needs to be amended to comport with the provisions of the Act.

Response: We will determine a State's nonparticipation in IEVS by an audit pursuant to the Single Audit Act. Specific auditing procedures for evaluating participation in IEVS are included in the Compliance Supplement to OMB Circular A–133. Anyone interested in the auditing procedures should review the Compliance Supplement for further information.

Since the statute allows us to regulate a penalty of ''not more than 2 percent,'' we could establish a penalty of less than two percent. However, we feel that a penalty of two percent is appropriate given that IEVS has been in effect for over 12 years and States have had ample time to come into compliance.

Comment: Some commenters suggested that we should impose a reduced penalty of less than two percent if the failure to operate IEVS was inadvertent, isolated, or of a technical nature. A few commenters indicated that the proposed rule is consistent with the TANF statutory requirements.

Response: If a State fails to meet the IEVS requirements, it may claim reasonable cause and/or submit a corrective compliance plan under part 262. Under these provisions, a State might be able to demonstrate that we should forgive or reduce its penalty under the types of situations mentioned by the commenters.

Section 264.30—What Procedures Exist to Ensure Cooperation With Child Support Enforcement Requirements? (§ 274.30 of the NPRM)

One of TANF's purposes is to provide assistance to needy families so that children may be cared for in their own homes or the homes of relatives. Another is to end the dependence of needy parents on government benefits by promoting job preparation, work, marriage, and parental responsibility. A third is to prevent and reduce the incidence of out-of-wedlock pregnancies and to encourage the formation and maintenance of two-parent families. Child support enforcement provides an important means of achieving all of these goals.

The law has long recognized that paternity establishment is an important first step toward self-sufficiency in cases where a child is born out of wedlock. The earlier paternity is established, the sooner the child may have a relationship with the father and access to child support, the father's medical benefits, information on his medical history, and other benefits resulting from paternity establishment. Establishment of paternity may also help establish entitlement to other financial benefits, including Social Security benefits, pension benefits, veterans' benefits, and rights of inheritance. Accordingly, establishing paternity and obtaining child support from the noncustodial parent are critical components of achieving independence.

To ensure that a legal relationship protecting the interests of the children is established quickly and in accordance with State law, the TANF (IV–A) agency must refer all appropriate individuals in the family to the Child Support Enforcement (IV–D) agency for paternity establishment and/or services needed to establish, modify, and enforce a child support order. Referred individuals must cooperate in establishing paternity and in establishing, modifying or enforcing a support order for a child.

The IV–D agency determines whether the individual is cooperating with the State as required. If the IV–D agency determines that an individual has not cooperated, and the individual does not qualify for any good cause or other exception established by the State, the IV–D agency will notify the IV–A agency promptly. The IV–A agency must then take appropriate action.

In cases of noncooperation, the IV–A agency must either deduct from the assistance an amount no less than 25 percent of the amount of the assistance that otherwise would be provided or deny the family assistance under the TANF program.

We received a few comments on the provisions in this section and made some modest changes to the regulations, as discussed below.

Comment: Several commenters suggested that we clarify agency responsibilities for making the good cause determination. They stated that the proposed preamble and regulation did not make it clear that the statute provides States with a choice about whether the TANF (IV–A) or IV–D agency determines good cause. One State recommended that the final regulations allow for IV–D agencies to negotiate with IV–A TANF agencies to determine good cause for noncompliance.

Response: We agree that States have discretion in this area. As provided in section 454(29)(A) of the Act, the title IV–A, IV–D or XIX (Medicaid) agency may determine whether the individual has good cause for not cooperating in establishing paternity or fulfilling any other cooperation requirement. The selection of the responsible agency is at the option of the State IV–D agency. We have revised the regulatory language at § 264.30(b) to clarify this point. We have also revised the language in § 264.30(b) to explicitly recognize that victims of domestic violence could receive waivers of child support cooperation requirements if a State has adopted the Family Violence Option.

Comment: Many commenters expressed concern that the use of the term "appropriate individual," used to indicate who must cooperate, suggests that Federal law requires cooperation by nonparents. They suggested that we modify the provision to clarify that Federal law mandates cooperation only with respect to parents who apply for TANF assistance for their own children.

Response: We agree with the commenters that Federal law does not require cooperation by other individuals. However, the language in the proposed rule recognized that it might be appropriate to require cooperation by other caretakers who have access to information that could be used to establish paternity or obtain child support on behalf of the child. Since we believe States should have some discretion to require cooperation in these cases, we have chosen to leave the term "appropriate individuals" in the regulation. At the same time, we would point out that other individuals would not ordinarily have the same level of information about the absent parent as a parent would. Thus, we would expect States to develop procedures that recognize this difference and apply a different standard in determining cooperation by nonparents.

Comment: One commenter suggested that it was unnecessary to include the language "for whom paternity has not been established" in either the preamble or the regulation since even if paternity was previously established, the IV–D agency must carry out child support enforcement activities, such as enforcing and modifying child support orders for children whose paternity has already been established.

Response: We disagree. Section 409(a)(5) specifically mentions cooperation in establishing paternity. We would note that the language in § 264.30(a) covers the other situations mentioned by the commenter, especially where it says "* * * or for whom a child support order needs to be established, modified or enforced. * * *"

Comment: Several commenters recommended that we mandate a set of notice and procedural requirements for cooperation that States would need to include in their systems. One commenter suggested that we should not allow a State to impose sanctions unless there is verification that the agency has met its duty of notifying recipients. Others felt that: (1) The notices should inform TANF applicants and recipients about the cooperation requirement and the good cause and other exceptions; (2) there should be a mechanism by which an individual who has been referred to the IV–D agency for child support services can make a claim for an exemption from the cooperation requirement if it appears that one is needed; (3) there should be an interface between the IV–A and IV–D agencies when the State has set up a system in which the IV–A agency makes the "good cause" determinations and the IV–D agency makes cooperation decisions; and (4) an individual should be informed about a noncooperation decision and how to appeal such a decision.

Response: The statute does not give us the authority to require specific notice and procedural criteria from States. However, as the cooperation requirement is not new, States already have administrative processes in place that support fair and equitable treatment of individuals, including notices of certain requirements under this section. States are required to submit State plans that describe individual State program operations and requirements. Child Support is one of the plans required.

Section 264.31—What Happens if a State Does Not Comply With the IV–D Sanction Requirement? (§ 274.31 of the NPRM)

In accordance with section 409(a)(5), we will impose a penalty of up to five percent of the adjusted SFAG if the IV–A agency fails to enforce penalties requested by the IV–D agency against individuals who fail to cooperate without good cause. We will monitor State adherence to this requirement primarily through the single audit process.

Although States had been required to establish paternity and enforce other child support provisions for several years, and States already had systems and procedures in place for dealing with these requirements, the division of responsibility between the IV–A and IV–D agencies changed slightly under PRWORA.

We decided to increase the amount of the penalty gradually in order to give States the opportunity to make procedural adjustments before they are subject to the impact of the maximum penalty. We will impose a penalty of one percent for the first violation and two percent for the second. However, since this is not an entirely new requirement, we will apply the maximum penalty of five percent for the State's third, and any subsequent, violation of this provision.

We received two comments specifically addressing the provisions in this section. As a result, we made some minor changes to the regulations, as discussed below.

Comment: One commenter suggested that individuals who receive waivers from the child support cooperation requirements pursuant to the Family Violence Option (FVO) should also be exempt from sanction and should not be considered in determining the need for a penalty under this subsection.

Response: Although a separate section of the Act authorizes waivers under the FVO for victims of domestic violence, the purpose of these waivers and the regular good cause exceptions from child support cooperation are similar, i.e., to protect families that face special risks from inappropriate requirements and sanctions. We encourage States to establish an administratively efficient process to coordinate these two determinations. Coordinating them should help States minimize duplication of effort, avoid confusion and jurisdictional problems, and treat families in similar circumstances consistently. (See § 260.57 for additional discussion of FVO waivers and sanction policies.)

Comment: One commenter suggested we add a further criterion to specify that we will not penalize a State if the violations were de minimus.

Response: We believe that the reasonable cause criterion at § 262.5(a)(3) adequately covers such situations.

Section 264.40—What Happens if a State Does Not Repay a Federal Loan? (§ 274.40 of the NPRM)

Section 406 permits States to borrow funds to operate their TANF programs. In general, States must use these loan funds for the same purposes as other Federal TANF funds. However, the statute also specifically provides that States may use such loans for welfare anti-fraud activities and for the provision of assistance to Indian families that have moved from the service area of an Indian Tribe operating a Tribal TANF program.

States have three years to repay loans and must pay interest on any loans received. Our Office of Administration has issued an Action Transmittal, OFA–TANF–98–2, dated February 3, 1998, notifying States of the application process and the information needed for the application.

Section 409(a)(6) establishes a penalty for States that do not repay loans provided under section 406. If the State fails to repay its loan in accordance with its agreement with ACF, we will reduce the adjusted SFAG for the immediately succeeding fiscal year by the outstanding loan amount, plus any interest owed.

Sections 409(b)(2) and 409(c)(3) provide that States cannot avoid this penalty either through reasonable cause or corrective compliance.

We received no comments on the provisions in this section. Therefore, the final rule incorporates the proposed policy.

Section 264.50—What Happens if, in a Fiscal Year, a State Does Not Expend, With Its Own Funds, an Amount Equal to the Reduction to the Adjusted SFAG Resulting From a Penalty? (§ 274.50 of the NPRM)

Section 409(a)(12) requires States to expend, under the TANF program, an amount equal to the reduction made to its adjusted SFAG as a result of one or more of the TANF penalties. Thus, States must maintain a level of TANF spending that is equivalent to the funding provided through the SFAG, even if we reduced their Federal funding as a result of penalties. If a State fails to expend its own funds to pay for State TANF expenditures in an amount equal to the reduction made to its adjusted SFAG for a penalty under § 262.1, we will reduce the State's SFAG for the next fiscal year by an amount equal to not more than two percent of its adjusted SFAG, plus the amount that the State should have expended (reduced for any portion of the required amount actually expended by the State in the fiscal year).

As discussed in § 262.3, we will monitor closely a State's efforts to replace the reduced SFAG with its own expenditures. A State must not diminish its investment in its TANF program as a result of actions violative of the TANF requirements. Therefore, if a State fails to make any expenditures in the TANF program to compensate for penalty reductions, we will penalize the State in the maximum amount, i.e., two percent of the adjusted SFAG plus the amount it was required to expend. We will reduce the penalty based on the percentage of any expenditures that the State does make.

For example, a State was required to replace an SFAG reduction of $1,000,000, but its increase in expenditures equalled only $400,000. Since it failed to repay $600,000, its penalty would be equal to two percent of the adjusted SFAG times 60 percent (because $600,000 is 60 percent of $1,000,000), plus the $600,000 that it failed to expend as required.

States should note that if they do not expend State-only funds as required, the effect will be that the amounts to be deducted from the SFAG will compound yearly, as the penalty for failure to replace SFAG funds with State expenditures also applies to the penalty at § 262.1(a)(12). We believe that this is appropriate because full resources must be available to ensure that the goals of the TANF program are met.

Pursuant to section 409(a)(12), State expenditures that are used to replace reductions to the SFAG as the result of TANF penalties must be expenditures made under the State TANF program, not under "separate State programs." Further, as noted in § 263.6, regarding the limits on MOE expenditures, State expenditures made to replace reductions to the SFAG as a result of penalties do not count as basic MOE expenditures.

In addition, the statute provides that the reasonable cause and corrective compliance plan provisions do not apply to the penalty for failure to replace SFAG reductions.

We received a few comments on this section. These comments resulted in changes, as discussed below.

Comment: A commenter asked if a State's replacement of funds must occur in the quarter following the imposition

of the penalty or in the next fiscal year. The commenter preferred replacement during the next fiscal year because of differences in State appropriation cycles. Another commenter suggested that the proposed rule did not comport with the language of the statute.

Response: We agree with the comments. We have revised the regulatory language at § 264.50 to reflect the sequence of penalty actions as contained in the statute at section 409(a)(12). When we withhold Federal TANF funds during a fiscal year, the State must replace them with State funds during the subsequent fiscal year. If the State fails to replace the funds during the subsequent year, then we can withhold an additional penalty during the year that follows the subsequent year. The starting point for this sequence of actions is the fiscal year in which we impose a penalty by reducing the adjusted SFAG.

Comment: A commenter recommended that we allow reasonable cause and corrective compliance when a State fails to expend its own funds to replace a reduction in the adjusted SFAG caused by other penalties.

Response: The statute prohibits reasonable cause or corrective compliance when a State fails to replace the reduction to its SFAG due to the imposition of other penalties.

Comment: One commenter suggested that we should allow States to expend the replacement funds on State-only programs that serve the TANF population.

Response: Section 409(a)(12) explicitly refers to ''the State programs funded under this part,'' which means the TANF program established under title IV–A of the Act. Separate State programs, funded exclusively with State funds, are not part of the State TANF program funded under title IV–A of the Act.

Subpart B—What Are the Requirements for the Contingency Fund?

In addition to the TANF funding they receive under section 403(a) of the Act, States may receive funding from the Contingency Fund under section 403(b). This fund was created in response to concerns related to the use of block grant funding for TANF and the end of entitlement and open-ended Federal funding of welfare assistance that existed under the AFDC program. The purpose of the Contingency Fund is to make additional Federal TANF funds available to States, at their request, for periods when unfavorable economic conditions threaten their ability to operate their TANF programs. The Fund was established to create a pool of Federal TANF funds that could be provided to needy States with economic problems.

We received several comments on the Contingency Fund sections of the NPRM. Most of the commenters asked us to make the preamble and regulations more consistent and less confusing, and to provide further clarification of the provisions. As a result, we have revised all of subpart B, restructured the sections, and amended our discussion of the provisions. Also, we have changed many of the section headings to make them clearer and to eliminate duplication. Whenever possible, we reference the sections that we used in the NPRM to make it easier for the reader. We hope that we have succeeded in making improvements and that the Contingency Fund provisions are now easier to understand. However, we have not made substantive changes to the underlying policies or procedures of this subpart because the proposed regulatory provisions closely followed the statute.

In addition to the changes we made in response to comments, we eliminated a discussion on ''Meeting FY 1997 MOE Requirements'' that was included at the end of the preamble to subpart B of part 274 of the NPRM. We believe that it is no longer necessary to include this specific discussion about the handling of the Contingency Fund in FY 1997.

This final rule also differs from the NPRM in that we added information about the overall adjustment of the Contingency Fund, and the additional remittances of contingency funds that will be due from States, that are required by the Adoption and Safe Families Act of 1997, which was enacted just as the NPRM was about to be published.

Section 264.70—What Makes a State Eligible To Receive a Provisional Payment of Contingency Funds? (New Section)

As noted in the definitions at § 260.30, the term ''Contingency Fund'' refers to the Federal TANF funds that a State may receive under section 403(b). It does not refer to any required State expenditures.

To receive a provisional payment of contingency funds, a State must qualify as a needy State for one or more months in a fiscal year. A needy State may request contingency funds in accord with the process delineated in program instruction TANF–ACF–PI–97–8, dated October 27, 1997. This program instruction provides guidance to States on the requirements for receiving contingency funds and instructions for applying for these funds.

A State is a ''needy State'' if it meets either the ''unemployment trigger'' or the ''Food Stamp trigger'' for an ''eligible month.''

To be eligible for contingency funds under the unemployment trigger, the State's average unemployment rate for the most recent three-month period must be at least 6.5 percent and at least equal to 110 percent of the State's unemployment rate for the corresponding three-month period in either of the two preceding calendar years.

To be eligible for contingency funds under the Food Stamp trigger, a State's monthly average of individuals participating in the Food Stamp program (as of the last day of each month) for the most recent three-month period must exceed its monthly average of individuals in the corresponding three-month period in the Food Stamp caseload for FY 1994 or FY 1995 by at least ten percent, assuming that the immigrant provisions under title IV and the Food Stamp provisions under title VIII of PRWORA had been in effect in those years.

The statute defines an eligible month as a month in a two-month period that begins with any month for which the State is determined to be a needy State. Once a State becomes a needy State for any given month (by meeting either the unemployment or Food Stamp triggers) and elects to receive contingency funds, it will receive a provisional payment for a two-month period. Based on the statutory definition of an eligible month, a determination that a State is a needy State for a month makes that State eligible to receive a provisional payment of contingency funds for two consecutive months, at the State's option.

Territories and Tribal TANF grantees are not eligible to participate in the Contingency Fund. Section 403(a)(7) provides that only the 50 States and the District of Columbia are eligible.

Section 264.71—What Determines the Amount of the Provisional Payment of Contingency Funds That Will Be Made to a State? (New Section)

The amount of contingency funds paid to a State is considered to be provisional because the actual amount that the State is eligible to receive is not determined when the payment is made, but, rather, after the fiscal year ends. As we discuss in § 264.73, a State that received contingency funds must complete an annual reconciliation to determine whether it must remit some or all of the contingency funds it received.

For each month of the fiscal year that it meets the eligibility criteria in § 264.70, a State may receive up to 1/12th of 20 percent of its annual SFAG allocation. The actual amount of funds that a State may realize from the Contingency Fund will vary, depending on the level of State expenditures, the number of months that it is eligible, and the total number of States receiving contingency funds. States eligible in one month may automatically receive a payment for the following month.

We will provide contingency funds to each State that requests them, in the order in which we receive the requests, until the available appropriated funds are exhausted.

Section 264.72—What Requirements Are Imposed on a State if It Receives Contingency Funds? (New Section)

In order to be eligible for contingency funds, a State must make expenditures in its TANF program, from State funds, at the required Contingency Fund MOE level. The required Contingency Fund MOE level is 100 percent of the State's historic State expenditures for FY 1994.

To keep any of the contingency funds it received, a State must exceed the Contingency Fund MOE level requirement. A State may keep only the amount of contingency funds that match, at the applicable Federal Medical Assistance Percentage (FMAP) rate, countable State expenditures, as defined in § 264.0, that are in excess of the required Contingency Fund MOE level, reduced by the proportionate remittance required by the Adoption and Safe Families Act of 1997. Because of the reconciliation formula, it is possible that a State may not be able to keep any of the contingency funds it received. Please refer to the discussion of § 264.73 on the annual reconciliation for more information.

You should note that the Contingency Fund MOE requirement is different from the basic MOE requirement. An obvious difference is that the basic MOE requirement is 80 percent (or 75 percent if a State meets its participation rates) of historic State expenditures, while the Contingency Fund MOE requirement is 100 percent of historic State expenditures. Another difference is that, in determining the Contingency Fund MOE level, expenditures for child care must be excluded. Finally, expenditures in separate State programs also must be excluded in determining countable expenditures.

This means that States cannot meet the Contingency Fund MOE requirement merely by increasing State expenditures by 20 (or 25) percent. The calculations for determining compliance with the basic MOE requirements and for determining eligibility for the Contingency Fund are different. For example, Contingency Fund MOE expenditures must be expenditures within TANF. Expenditures made under separate State programs do not count for this purpose. However, most MOE expenditures that a State makes within its TANF program for eligible families may count as both Contingency Fund MOE expenditures and as basic MOE expenditures.

As we discuss in § 264.73, each State that receives contingency funds is required to complete an annual reconciliation to determine what portion of the contingency funds it may retain and what portion it must remit.

The statute provides that a State need not remit contingency funds until one year after it has failed to meet either the Food Stamp trigger or the unemployment trigger for three consecutive months. Thus, a State may retain these funds for at least 14 months after it receives them. (However, the period of time between the annual reconciliation and the remittance date may be shorter.)

For example, if a State fails to meet either trigger for the months of July, August, and September, 1997, it has until September 30, 1998, to remit the funds. The State must include its annual reconciliation for contingency funds received in FY 1997 in its fourth quarter Financial Report for FY 1997, due November 14, 1997.

In general, contingency funds may be used for the same purposes as other Federal TANF funds. However, contingency funds are available only for qualifying expenditures made in the fiscal year in which the State receives the funds. States may not use funds received in a given fiscal year for expenditures made in either the subsequent fiscal year or a prior fiscal year. Unlike TANF funds under section 403(a), contingency funds are not available until expended.

Since contingency funds are Federal TANF funds, they are generally subject to the same requirements as other Federal TANF funds. For example, a State cannot use contingency funds to pay a family if the family has already received Federal assistance for 60 months, unless the family has received an exception under § 264.1. (See the discussion in § 263.21 on "Misuse of Federal TANF Funds" for additional information.)

However, unlike the TANF funds that they receive under section 403(a), States cannot transfer contingency funds (provided under section 403(b)) to the Child Care and Development Block Grant Program (also known as the Discretionary Fund of the Child Care and Development Fund) and/or the Social Services Block Grant Program under title XX of the Act. Section 404(d) of the Act permits the transfer of funds received pursuant to section 403(a) only.

Section 264.73—What Is an Annual Reconciliation? (New Section)

The purpose of the annual reconciliation is to determine the amount of contingency funds that a State is permitted to retain for a fiscal year. The annual reconciliation involves computing the amount by which the State's countable State expenditures exceeds the State's required Contingency Fund MOE level, as contingency funds match only these excess expenditures. If the countable expenditures exceed the required Contingency Fund MOE level, then the State may be entitled to all or a portion of the contingency funds paid to it. However, even if its countable expenditures exceed its required Contingency Fund MOE level, it is possible that the provisions of the Adoption and Safe Families Act of 1997, amending section 403(b)(6), will have a major impact on the amount of contingency funds that a State is permitted to retain. In fact, it may prevent a State from retaining any contingency funds.

Each State that received contingency funds is required to perform certain calculations to accomplish the annual reconciliation. First, it must determine whether it met its required Contingency Fund MOE level. If it did not, it must remit all of the contingency funds it received.

If it met its Contingency Fund MOE requirement, the State must also perform the following steps to determine how much of the contingency funds it is permitted to retain:

(1) Calculate the sum of the amount of the qualifying State expenditures plus the amount of contingency funds that the State expended, minus its required Contingency Fund MOE level.

(2) Multiply the amount arrived at in step (1) by the State's FMAP rate applicable for the fiscal year in which contingency funds were awarded.

(3) Multiply the amount arrived at in step (2) by 1/12 times the number of months during the fiscal year for which the State received contingency funds.

(4) Compare the amount arrived at in step (3) with the amount of contingency funds paid to the State during the fiscal year, and determine the lesser amount.

(5) From the amount arrived at in step (4), subtract the State's proportionate

remittance for the overall adjustment of the Contingency Fund, as required by the Adoption and Safe Families Act of 1997.

The Adoption and Safe Families Act of 1997 reduced the Contingency Fund appropriation over the four-year period from FY 1998 through FY 2001. All States receiving contingency funds in these years must remit additional funds in order to share in the adjustment proportionately. The remittance amounts of all States drawing from the Contingency Fund will be increased by proportional shares totaling $2 million in FY 1998, $9 million in FY 1999, $16 million in FY 2000, and $13 million in FY 2001. Thus, the fewer the number of States receiving contingency funds, the higher each proportionate share of the adjustment will be, and the more each State will have to remit. ACF will determine the amount of each State's proportionate remittance and will provide this information to the State for it to use in its annual reconciliation calculations.

A State should also note that if it was eligible for, and received, contingency funds for fewer than 12 months during the fiscal year, the effective Federal matching rate for contingency funds will be less than its FMAP rate for the fiscal year. The effective rate is lower because the statute creates a reconciliation step that reduces the total Federal matching by 1/12 times the number of eligible months in the year.

Below we provide an example for FY 1998 that requires the remittance of funds. Assume the following information:

A State received a provisional payment of $2.5 million in contingency funds for six months of eligibility in the fiscal year. Its qualifying State expenditures were $102.5 million, its expenditure of contingency funds was $2.5 million, and its child care expenditures were $2 million. The required expenditure of State funds to meet the 100-percent MOE level is $95 million ($100 million minus $5 million for historic child care expenditures). The State's FMAP is 50 percent. This is the only State that received contingency funds in fiscal year 1998.

Based on the information provided, we see that the State met its required Contingency Fund MOE level.

To continue with the annual reconciliation, we use the steps outlined above.

(1) $102.5 million, plus $2.5 million, minus $2 million, minus $95 million, equals $8 million. (The State's qualifying State expenditures, plus its expenditure of contingency funds, minus its child care expenditures, minus its required Contingency Fund MOE level.)

(2) $8 million, times 50 percent, equals $4 million. (The result of step (1) multiplied by the State's FMAP rate.)

(3) $4 million, times 1/12, times 6, equals $2 million. (The result of step (2) multiplied by 1/12 times the number of months the State received funding for the Contingency Fund.)

(4) The lesser amount of $2 million, compared to $2.5 million, is $2 million. (The lesser of the result of step (3) compared to the amount of contingency funds the State received.)

Were it not for the requirements of the Adoption and Safe Families Act of 1997, the State would have been eligible to retain $2 million in contingency funds and would have been required to remit $500,000. However, we are required to increase the amount the State must remit, which we accomplish in step (5).

(5) $2 million, minus $2 million, equals zero. (The overall adjustment required from all States that received contingency funds for FY 1998 is $2 million. Since only one State received contingency funds, its proportionate offset is 100 percent of $2 million. Thus, the State's remittance is increased by $2 million, and the State can retain no contingency funds. Under the assumptions we presented, the State is required to remit its entire $2.5 million provisional payment of contingency funds.)

The example above illustrates a case where the State had to remit the entire amount of the $2.5 million provisional payment of contingency funds it received even though it made expenditures above the required Contingency Fund MOE level. If additional States had drawn contingency funds for the fiscal year, this State's proportional remittance would have been smaller, and the State would have been able to retain some of the contingency funds it received.

We will not consider a State's use of contingency funds, which later must be returned under the reconciliation formula, to be an improper use of funds, and, if the State meets its Contingency Fund MOE requirement, we will not assess that penalty.

Section 264.74—How Will We Determine the Contingency Fund MOE Level for the Annual Reconciliation? (§ 274.71 of the NPRM)

For the Contingency Fund, historic State expenditures for FY 1994, the base MOE level, include the State's share of AFDC benefit payments, administration, FAMIS, EA, and JOBS expenditures. They do not include the State's share of AFDC/JOBS, Transitional and At-Risk child care expenditures. States must meet 100 percent of this MOE level.

We said we would use the same data sources and date, i.e., April 28, 1995, to determine each State's historic State exependitures as we used to determine the basic MOE requirement. However, we would exclude the State share of child care expenditures for FY 1994.

We will reduce the required MOE level for the Contingency Fund if a Tribe within the State receives a Tribal Family Assistance Grant under section 412. The last paragraph of section 409(a)(7)(B)(iii) provides for this reduction. For the basic MOE requirement, we will reduce the State's basic MOE level by the same percentage as we reduce a State's annual SFAG allocation for Tribal Family Assistance Grants in the State for a fiscal year. For example, if a State's SFAG amount is $1,000 and Tribes receive $100 of that amount, we would reduce the State's basic MOE requirement by ten percent. If the same State also receives contingency funds in that fiscal year, we would also reduce the Contingency Fund MOE level by ten percent.

Section 264.75—For the Annual Reconciliation, What Are Qualifying State Expenditures? (§ 274.72 of the NPRM)

Section 403(b)(6)(B)(ii)(I) provides that State expenditures counted toward the Contingency Fund MOE may only include expenditures made under the State program funded under this part. Thus, the State expenditures that the State makes to meet the required Contingency Fund MOE level include the expenditure of State funds within TANF only; they do not include expenditures made under separate State programs. In addition, under this section of the statute a State may not use expenditures for child care to meet the Contingency Fund MOE requirement or to qualify the State to retain any of the contingency funds it received. Thus, we have noted the exception for child care in item 3 below. (This exception appears in paragraph (b) of the regulatory text.)

In the NPRM, we referred to sections of part 273 to define qualifying State expenditures for the Contingency Fund. In these final regulations, we have eliminated references to the basic MOE sections; we believe they were confusing because there were a number of differences in the expenditures that are permitted to be included in calculating the basic MOE and the Contingency Fund MOE.

Nevertheless, we retain some of the proposed policies. More specifically, qualifying State expenditures, for

Contingency Fund MOE purposes, are expenditures, with respect to eligible families, of State funds made in the State TANF program for the following:

(1) Cash assistance, including assigned child support collected by the State, distributed to the family, and disregarded in determining eligibility for, and amount of the TANF assistance payment;

(2) Educational activities designed to increase self-sufficiency, job training, and work, excluding any expenditure for public education in the State except expenditures involving the provision of services or assistance to an eligible family that are not generally available to persons who are not members of an eligible family;

(3) Any other services allowable under section 404(a)(1) of the Act and consistent with the goals at § 260.20 of this chapter (except child care); and

(4) Administrative costs in connection with the provision of the benefits and services listed in paragraphs (a)(1) through (a)(3), but only to the extent consistent with the administrative cost cap for MOE expenditures at § 263.2(a)(5).

Further, in § 260.31(c)(1), we have added a reference to this subpart. This revised language clarifies that, like basic MOE, Contingency Fund MOE may be expended on benefits and services that do not meet the definition of assistance.

In item 4 above, regarding the limits on administrative costs, we have modified the preamble and regulatory language to avoid the creation of a third administrative cost cap. Under the statute and the rules, we already provide for a 15-percent cap on the portion of Federal grant funds and State basic MOE expenditures that go to administrative costs. If we said that Contingency Fund MOE expenditures were subject to a similar administrative cost cap, States and we would then have three administrative cost caps to track.

In general, we believe the basic MOE requirements should apply to Contingency Fund MOE expenditures. However, in our minds, this view did not justify the creation of a third administrative cost cap, especially because of the substantial overlap between the Contingency Fund MOE expenditures and basic MOE expenditures. Rather, under these rules, we require that State expenditures on administrative costs, for Contingency Fund MOE purposes, must be consistent with the basic MOE administrative cost cap. In other words, in making MOE expenditures for Contingency Fund purposes, States must take care not to spend excess amounts on administrative costs. Their expenditures on administrative costs must be at a level that enables their compliance with the existing 15-percent cap in the basic MOE provisions.

Section 264.76—What Action Will We Take if a State Fails To Remit Funds After Failing To Meet Its Required Contingency Fund MOE Level? (§ 274.75 of the NPRM)

PRWORA established a penalty at section 409(a)(10) that provides that, if a State does not meet the Contingency Fund MOE requirement and remit funds as required, we must reduce the State's SFAG payable for the next fiscal year by the amount of funds that the State has not remitted. The statute prohibits us from waiving or reducing this penalty based on reasonable cause or corrective compliance. However, the State may appeal our decision to reduce the State's SFAG pursuant to the regulations at § 262.7.

Section 264.77—How Will We Determine if a State Has Met Its Contingency Fund Expenditure Requirements? (§ 274.76 of the NPRM)

ACF has created a TANF Financial Report, the ACF–196. States will use the ACF–196 to report their use of Federal TANF funds, including contingency funds. We will use this report to verify the State's annual reconciliation after the end of the fiscal year. We will review it to ensure that expenditures reported are consistent with the statute and these rules. Please see the discussion of part 265 for additional information.

Subpart C—What Rules Pertain Specifically to the Spending Levels of the Territories?

In the preamble to the NPRM, we noted that section 103(b) of PRWORA amended section 1108. Section 1108 establishes a funding ceiling for Guam, the Virgin Islands, American Samoa and Puerto Rico. Prior to PRWORA, the following programs authorized in the Act were subject to this ceiling: AFDC and EA under title IV–A; Transitional and At-Risk Child Care programs under title IV–A; the adult assistance programs under titles I, X, XIV, and XVI; and the Foster Care, Adoption Assistance, and Independent Living programs under title IV–E. The ceiling excluded funding for the JOBS program, which also covered AFDC/JOBS child care.

Under the amendments in PRWORA, the funding ceiling at section 1108 applies to the TANF program under title IV–A, the adult programs, and title IV–E programs. Section 1108(b) provides a separate appropriation for a Matching Grant, which is also subject to a ceiling. The Matching Grant is not a new program; rather it is a new funding mechanism that Territories can use for expenditures under the TANF and title IV–E programs.

Prior to PRWORA we had not regulated the provisions of section 1108. However, in light of this new MOE requirement within section 1108, we thought that we needed to regulate to clarify the requirements and the consequences if a Territory failed to meet the new section 1108 requirements. We have authority to issue rules on this provision under section 1102, which permits us to regulate where necessary for the proper and efficient administration of the program, but not inconsistent with the Act. (The limit at section 417 does not apply to this section of the Act.) In addition, we prepared a program instruction for the Territories to provide additional guidance on receiving funds under section 1108.

In February 1997, we provided to the Territories: (1) Their FAG annual allocations; (2) their basic MOE levels under section 409(a)(7); (3) their Matching Grant MOE levels; (4) their section 1108(e) MOE levels (which were created by PRWORA and were subsequently eliminated by Pub. L. 105–33); and (5) a detailed explanation of the methodology and expenditures we used to determine each of these amounts.

Section 264.80—If a Territory Receives a Matching Grant, What Funds Must It Expend? (§ 274.80 of the NPRM)

Section 1108(b) provides that Matching Grant funds are available: (1) To cover 75 percent of a Territory's expenditures for the TANF program and the Foster Care, Adoption Assistance and Independent Living programs under title IV–E of the Act; and (2) for transfer to the Social Services Block Grant program under title XX of the Act or the Child Care and Development Grant (CCDBG) program (also known as the Discretionary Fund of the Child Care and Development Fund) pursuant to section 404(d) of the Act, as amended by PRWORA and Pub. L. 105–33. However, Matching Grant funds used for these purposes must exceed the sum of: (1) The amount of the FAG without regard to the penalties at section 409; and (2) the total amount expended by the Territories during FY 1995 pursuant to parts A and F of title IV (as so in effect), other than for child care.

Under the first requirement, the Territory must spend an amount up to its Family Assistance Grant annual allocation using Federal TANF or Federal title IV–E funds or funds of its own for TANF or title IV–E programs.

The second requirement establishes an MOE requirement at 100 percent of historic expenditures, based on the Territory's FY 1995 expenditures. This second requirement is separate from the basic MOE requirement and is applicable only if a Territory requests and receives a Matching Grant. Historic expenditures include 100 percent of State expenditures made for the AFDC program (including administrative costs and FAMIS), EA, and the JOBS program. Territorial expenditures made to meet this requirement include Territorial, not Federal, expenditures made under the TANF program or title IV–E programs.

Territorial expenditures can only be counted once to meet the FAG amount requirement, the MOE requirement, or the matching requirement. In other words, any given expenditure cannot be counted more than once to meet these three different expenditure requirements. We believe this policy is appropriate because our interpretation of the statute is that Congress intended that the provisions on spending up to the FAG amount, meeting the MOE requirement, and meeting the matching requirement be separate requirements.

Comment: One commenter pointed out that this section of the rule would more closely correspond to section 1108(b)(1)(B)(i) of the Act if we added the phrase ''without regard to any penalties applied in accordance with section 409'' to the regulation. Another commenter suggested that we needed to clarify what the historic expenditures were for the Territories.

Response: As suggested, we have added the phrase about disregarding penalties to the regulations. We also have added an explanation to the preamble that the historic expenditures for the Territories are the amounts spent above their Federal funding for the AFDC and EA programs up to, but not exceeding, the 25-percent Territorial match, plus the amount of matching funds spent for the JOBS program.

Section 264.81—What Expenditures Qualify for Territories To Meet the Matching Grant MOE Requirement? (§ 274.81 of the NPRM)

As stated in the NPRM, for the basic MOE, section 409(a)(7) includes specific provisions on what States and Territories may count as ''qualified State expenditures'' (i.e., expenditures that may count towards the basic MOE requirement).

However, the statute provides little guidance on what expenditures a Territory may count toward its Matching Grant MOE for IV–A expenditures. Because the Matching Grant is intended to be used for the TANF program, we decided to apply many of the basic MOE requirements in part 263, subpart A, to the Matching Grant MOE. These sections are: § 263.2 (What kinds of State expenditures count toward meeting a State's annual spending requirement?); § 263.3 (When do child care expenditures count?); § 263.4 (When do educational expenditures count?); and § 263.6 (What kinds of expenditures do not count?). Section 263.5 (When do expenditures in separate State programs count?) does not apply because section 1108(b)(1)(B)(ii) requires that the matching Grant MOE expenditures must be expenditures under the TANF program. Thus, expenditures to meet the Matching Grant MOE requirement may not be expenditures made under separate State programs. (Because Territories do not receive Matching Child Care funds, the limit on child care expenditures in § 263.3 does not apply.)

Also, Territorial expenditures made in accordance with Federal IV–E program requirements may count toward this MOE requirement. These include the State share of IV–E expenditures and expenditures funded with the State's own funds that meet Federal title IV–E program requirements.

The Territories may count expenditures made pursuant to the regulations at 45 CFR parts 1355 and 1356 for the Foster Care and Adoption Assistance programs and section 477 of the Act for the Independent Living program.

Territories may also count toward their Matching Grant MOE requirement expenditures made under the TANF program that meet the basic MOE requirement.

We received no comments on this section and made no changes to the regulation.

Section 264.82—What Expenditures Qualify for Meeting the Matching Grant FAG Amount Requirement? (§ 274.82 of the NPRM)

The statute intends that expenditures made to meet this requirement must be TANF or title IV–E expenditures. For TANF expenditures, the Territories may count allowable expenditures of Federal TANF funds to meet this requirement. They may count amounts that they have transferred from TANF to title XX and the Discretionary Fund in accordance with section 404(d). (See § 263.11, which describes the proper uses of Federal TANF funds.) Also, a Territory may count its own expenditures under the TANF program, for this purpose. Because IV–A expenditures made with the Territories' own funds must be for the TANF program, it is reasonable that we apply the MOE requirements applicable for the Matching Grant to this FAG amount requirement.

For IV–E expenditures, as with the Matching Grant MOE, expenditures made in accordance with Federal IV–E program requirements may count toward this MOE requirement. These include the Federal share and the Territories' share of IV–E expenditures and expenditures funded with the Territories' own funds that meet Federal IV–E program requirements.

We received no comments on this section and made no changes to the regulation.

Section 264.83—How Will We Know if a Territory Failed To Meet the Matching Grant Funding Requirements at § 264.80? (§ 274.83 of the NPRM)

We are developing a separate Territorial Financial Report for the Territories. We will require this report to be filed quarterly and to cover all programs subject to the section 1108 caps. This report will cover basic MOE and Matching Grant MOE requirements. For the Matching Grant, Territories must report expenditures claimed under title IV–E and IV–A and the total expenditures (including Federal) they make to meet the requirement that they spend up to their Family Assistance Grant annual allocations.

We would not require Territories to file the TANF Financial Report; however, they must report comparable information on the Territorial Financial Report. Furthermore, if one of the Territories fails to file the Territorial Financial Report or to include certain information in that report, we would treat it like a State that fails to file its TANF Financial Report and make it subject to the penalty for failure to report at § 262.1(a)(3).

We received no comments on this section and made no changes to the regulation.

Section 264.84—What Will We Do if a Territory Fails To Meet the Matching Grant Funding Requirements at § 264.80? (§ 274.84 of the NPRM)

The statute does not address the consequences for a Territory if it fails to meet the Matching Grant MOE and the FAG amount requirements. The proposed and final rules provide that we would disallow the entire amount of a fiscal year's Matching Grant if the Territory fails to meet either requirement. This is because the statute provides that the Matching Grant funds are only allowable if a Territory meets both requirements. Thus, if a Territory does not meet either one or both of the requirements, it must return the funds

to us. We will get the funds back by taking a disallowance action.

A disallowance represents a debt to the Federal government. Therefore, we will apply our existing regulations at 45 CFR part 30. Once we issue a disallowance notice, we can require a Territory to pay interest on the unpaid amount.

We received no comments on this section and made no changes to the regulation.

Section 264.85—What Rights of Appeal Are Available to the Territories? (§ 274.85 of the NPRM)

The Territory may appeal a disallowance decision in accordance with 45 CFR part 16. As these are not penalties, the reasonable cause and corrective compliance provisions of section 409 do not apply. Section 410, covering the appeals process in TANF, also does not apply.

We received no comments on this section and made no changes to the regulation.

X. Part 265—Data Collection and Reporting Requirements (Part 275 of the NPRM)

A. Background

The TANF block grant legislation reflects a new emphasis on program information, measurement, and performance. This final rule specifies the data collection and reporting requirements that serve as the major mechanism to measure State accomplishment and performance.

We received many comments in response to the NPRM concerning the nature and scope of the data collection and reporting requirements.

In the preamble to the NPRM, we addressed two major purposes of data collection: to determine the success of the TANF program in meeting the purposes of the Act and to assure accountability under the Act. We also emphasized that it was critical to collect data that were comparable across States and over time and that would enable us to calculate participation rates.

We based the proposed reporting requirements primarily on section 411 of the Act (Data Collection and Reporting). We proposed quarterly reporting of both disaggregated and aggregated data on TANF recipients and some others in the household. We proposed similar reports of data on closed cases and on participants in separate State programs. We also proposed a quarterly financial report (with an annual addendum) and an annual program and performance report. Also included in this section of the NPRM were proposed provisions on reporting penalties, due dates, sampling, and electronic filing.

To enable the public to comment with full understanding of the reporting requirements, the NPRM included eleven appendices that contained the specific data elements, instructions for filing the information, sampling specifications, and the statutory reference for each data element. In the preamble, we also called readers' attention to the proposed data elements that were not specified in the statute, including break-outs of statutory requirements.

B. Overall Summary of Comments

While most commenters agreed on the need for data collection and reporting, States (including Governors, State legislators, State executive branch agencies, and national agencies representing State interests) expressed strong views that the proposed TANF data collection requirements were excessive. Other commenters did not generally share this view.

There was broader agreement among all commenters, however, that the proposed reporting requirements on separate State programs were excessive.

Several national, legal, and local advocacy organizations; private individuals; and Federal agencies strongly supported the data collection proposals as appropriate for tracking the effects of welfare reform and made recommendations for additional elements that they believed should be added. Likewise, other national organizations, States, and local public and private entities offered alternative recommendations. These recommendations included additional MOE expenditure data; expanded and more specific case closure data; information on applications approved, denied, and voluntarily withdrawn; and data to track longer term outcomes of recipients.

Many commenters provided detailed analysis and review of the NPRM, including the regulatory text, the preamble language, and the specific content of the Appendices.

The overwhelming majority of States objected to the increase in the number of data elements (in comparison to the number of elements in the Emergency TANF Data Report); claimed that we had underestimated the administrative burden and cost of collecting and reporting these data; and asserted that we lacked statutory authority for these expanded reporting requirements. They particularly objected to reporting on participants in separate State programs, the information on closed cases, and the annual program and performance report. (As discussed later, we believe that the objections to the case closure data were due largely to a misunderstanding of our expectations. In the final rule, we clarify that we are only requiring data for the month of closure, not longer tracking of former recipients.)

Almost all comments on the reporting requirements for the separate State programs found them to be excessively burdensome, contrary to the intent of the legislation, and inappropriate for some types of MOE programs. Commenters believed that such reporting requirements would limit the involvement of community-based organizations in the delivery of program services and have a chilling effect on State flexibility and the development of future innovative programs.

States were also concerned about sample sizes, sampling requirements, and the standards for "complete and accurate" reports that we proposed to apply in relation to the reporting penalty. A very few States reported an inability to report many of the specific data elements proposed in the NPRM based on long-standing problems in developing their information systems (although all States are reporting the data required in the Emergency TANF Data Report). Also, some States reported continuing problems in submitting standardized reports due to the autonomy of local jurisdictions.

C. Summary of Departmental Response

We continue to be committed to gathering information that is critically important in measuring the success of the TANF program and meeting the statutory requirements for program accountability.

We have seriously considered all comments and concerns of commenters in making changes to this rule. We appreciate the partnership approach many commenters demonstrated in developing their comments and the careful analysis evident in the extensive and detailed comments we received. These comments led to numerous refinements in the requirements that should help reduce burden, while maintaining the integrity and value of critical data.

In preparing this final rule, we have worked to ensure that our rules support the creativity and commitment that States and communities have shown in supporting families and moving them to work. As a result, we have accepted many of the recommendations to eliminate or reduce the burden of reporting, and we have made several substantive changes in this part. We

have also modified or expanded a very limited number of data elements.

We address the specific changes in detail in the section-by-section discussion below. Briefly, however, we have:

(1) Provided a phase-in period for the implementation of the data collection and other requirements; in the interim, the Emergency TANF Data Report (ETDR) will remain in effect (§ 260.40);

(2) Reduced the total number of data elements in the TANF Data Report from 178 to 124 and in the SSP–MOE Data Report from 160 to 108.

(3) Retained the definition of ''family'' for reporting on the TANF and the separate State programs, but made reporting of some data elements optional for certain members of the family (§§ 265.2 and 265.3(e));

(4) In section one of the TANF Data Report, reduced the number of and modified some data elements (disaggregated data on TANF recipients, Appendix A) (§ 265.3(b));

(5) In section two of the TANF Data Report, reduced the number of data elements; to address a misreading of the NPRM, clarified that we do not expect States to track closed cases, but only to report data on the last month of assistance; and modified the data element on reasons for case closure to include additional break-out items (disaggregated data on closed cases, Appendix B) (§ 265.3(b));

(6) In section three of the TANF Data Report, reduced the number of data elements (aggregate data, Appendix C) (§ 265.3(b));

(7) Changed the name of the TANF–MOE Data Report to the SSP–MOE Data Report to reflect the specific focus of the data collection in this report and reduced the number of data elements to be reported (Appendices E through G). Also, as the result of the revised definition of assistance, reduced the types of separate State programs covered by the SSP–MOE Data Report (265.3(d));

(8) In the TANF Financial Report, significantly revised the ACF–196 (the financial reporting form) by adding several categories of expenditures to reflect our new definition of assistance and modified the instructions to clarify reporting on expenditure data.

(9) Dropped the provision that required disaggregated and aggregated reporting on separate State programs as a condition for penalty reduction (§ 265.3(d));

(10) Clarified that States have considerable flexibility in designing their sampling plans (§ 265.5);

(11) Consolidated the annual reporting requirements on program definitions and State MOE program(s), as proposed in the Addendum to the fourth quarter TANF Financial Report, in a new Annual Report and added a number of new reporting requirements on State activities under the Family Violence Option, State diversion programs, and other program characteristics (§ 265.9);

(12) Eliminated, as separate reports, the annual program and performance report, intended to gather additional information for the Secretary's report to Congress and the fourth quarter Addendum to the TANF Financial Report; and

(13) Clarified our policies on issues such as reporting on noncustodial parents and penalty relief for less than perfect (''complete and accurate'') reporting (§§ 265.3(f), 265.7, and 265.8).

D. Section-by-Section Summary of and Response to Comments

Cross-Cutting Issues

Before we discuss the comments associated with specific sections of the regulatory text or the Appendices, we want to respond to three cross-cutting issues.

(a) Phase-in/Transition Period

Comment: More than 36 States and other commenters recommended a phase-in period to meet the reporting requirements. Commenters cited the administrative burden and the time needed to carry out the complex processes involved, e.g., making changes to State information systems, training staff, and synthesizing and reporting data with acceptable levels of confidence. States also saw this task made more difficult in the context of the need to make their systems Year 2000 (Y2K) compliant.

Response: We agree with the need for a phase-in period and have made the effective date of these and other requirements October 1, 1999. We believe this date gives States an adequate time period for implementation, in view of the reduced reporting burden and reduced number of data elements in the final rule, our positive experience with States in resolving initial data layout and transmission problems, and the fact that the States have 90 days after the end of the quarter to submit the data without risk of a penalty.

Regarding the Y2K compliance issues, we have taken a number of actions to raise awareness of the problem and respond to questions from human service providers. For example, we have established an Internet e-mail address and phone line and a Y2K web page. We have also distributed information packages to more than 7,000 human service providers and representative organizations, and we have added a reasonable cause criterion related to Y2K compliance. This new criterion provides penalty relief to a State if it can clearly demonstrate that addressing Y2K issues prevented it from meeting the reporting requirements for the first two quarters and it reports the first two quarters of data by June 30, 2000.

In addition, we encourage States to consider the use of sampling as a viable option while resolving such issues. There are advantages and disadvantages to sampling, as detailed in our response to comments later in this discussion.

In the interim, the Emergency TANF Data Report (ETDR) will remain in effect. The last ETDR will be due November 14, 1999. States will begin reporting data under this final rule beginning with the first quarter of FY 2000. The first TANF Data and Financial Reports under these new requirements are due February 14, 2000. See further discussion regarding the effective date of these rules in the preamble section relating to § 260.40.

(b) Extent of Reporting Requirements

As we developed the reporting requirements for the NPRM, we were conscious of the importance of data for program management purposes as well as for meeting statutory requirements. At the same time, we also were conscious of our direct authority to regulate on data collection and of those sections of the Act that provided the legal basis for the NPRM.

Section 417 provides that the Federal government may not ''regulate the conduct of the States under this part, or enforce any provision of this part, except to the extent expressly provided in this part.'' We believed at that time, and still believe, that this language provides authority to regulate what States must report in light of section 411(a)(7) of the Act. This section provides that,

> the Secretary shall prescribe such regulations as may be necessary to define the data elements with respect to which reports are required by this subsection * * *

We believed at that time, and continue to believe, that section 411(a)(7) clearly gives the Department authority to create and define data elements to administer the law.

We were conscious of other responsibilities as well. Not only must we collect the information specified in section 411 of the Act, but the information must be comparable and reliable in order to make decisions implementing other provisions of the

law, e.g., calculating the work participation rates, implementing penalties, ranking States, and reporting to Congress. We cannot perform these functions without adequate information. Unless the reported data meet certain standards, we cannot adequately meet our responsibilities under the law. Since States are the primary repository and only realistic source of this information, we must rely on them to supply the information we need.

Comment: Despite the inclusion in the NPRM of the Statutory Reference Tables, which provided the specific statutory citation or basis for each data element, and our explicit preamble discussion of, and rationale for, the few data elements not in the statute, there were a number of comments alleging that we lacked statutory authority to impose data collection requirements, even for the TANF recipient population. As evidence of their position, commenters pointed to the number of data elements in the ETDR (68) compared to the number of elements in Appendices A-C of the NPRM (178). They variously asserted that:

(1) We had statutory authority to collect only the 16 to 18 data elements in section 411(a)(1)(A);

(2) We had authority to collect only the data elements in the ETDR;

(3) We had no authority to add, define, or further specify or break-out the data elements in section 411(a)(1)(A); and

(4) It was not within our authority to collect data based on sections 409 (penalties), 413 (annual rankings of States), or 411(b) (reports to Congress).

Many commenters urged us to limit our data collection to the elements in the ETDR.

Some commenters did not identify the specific data elements of concern or the basis for their objection. Also, some did not distinguish between those data to which the reporting penalty applied and other data.

Some commenters rejected collection of any data that would be used for research and evaluation purposes and argued that the increased reporting requirements were due to the collection of information the Department thought it would be ''interesting to know.'' As an alternative, a few commenters recommended that we develop all reporting requirements using a collaborative approach that would identify outcome measures and performance indicators from which the data elements would then be derived.

Regarding the proposed annual program and performance report, many commenters stated that we had merely shifted to States the responsibility for preparing reports to Congress. They suggested that we obtain data needed for these reports by means of a national sample or other mechanism.

A number of commenters presented objections to the proposed data collection based on specific administrative and/or programmatic concerns. The data collection that raised the most concerns was the proposed reporting of data on closed cases and on participants in separate State MOE programs. Commenters said that the proposals on MOE reporting illustrated the distrust that States found throughout the NPRM and viewed it as an attempt to control State programs.

Response: We generally disagree with the comments indicating we lack authority to impose the proposed data collection requirements. The statute authorizes the Secretary to define the data elements and to specify the data elements needed to determine work participation rates. It also specifies that these definitions and data elements be established under regulations. Therefore, we were not able to include them in the ETDR. The additional data elements that go beyond the ETDR reflect our explicit rulemaking authority under section 411(a)(7) of the Act and the authority implicit in sections 409, 411(b), and 413 of the Act. We continue to believe that States are the primary source of the data needed for the report to Congress.

The ETDR collects only that information that was clearly specified in the statute. By necessity, it contains a streamlines list of data elements that we can use in the interim period until final regulations are in effect. It is not sufficient as a long-term data collection instrument. For example, it does not provide clear uniform definitions of data elements and does not include some critical elements, e.g., the social security number.

In developing the final rule, we have re-doubled our efforts to reduce unnecessary reporting burdens on the States and have carefully reviewed the justification for, and value of, each data element that we had proposed. Based on that review, and in response to the comments we received, we have eliminated or streamlined many data elements in the Appendices published with this final rule. See the chart below and a further description of the changes we have made in the section-by-section discussion of § 265.3. We believe this reduced set of data represents a reasonable balance between the requirements for data, our statutory authority, and the burden placed on States in providing this information.

TOTAL NUMBER OF DATA ELEMENTS—DATA REPORTS

Type of report	ETDR	NPRM	Final rule
TANF Data Report: Disaggregated data on TANF recipients	55	106	76
TANF Data Report: Disaggregated data on closed cases	6	53	30
TANF Data Report: Aggregated data	7	19	18
Subtotal	68	178	124
SSP–MOE Data Report: Disaggregated data on recipients	....	96	69
SSP–MOE Data Report: Disaggregated data on closed cases	....	49	27
SSP–MOE Data Report: Aggregated data	....	15	12
Subtotal	....	160	108
Total	68	338	232

Note: States must report on these data elements for all persons receiving assistance. Some data elements are optional for other persons in the family.

(c) Publishing the Appendices As a Part of the Rule

Comment: We received two types of comments on this issue. A few commenters urged us to publish the specific data elements as a part of the final rule and to codify them as a part of the Code of Federal Regulations (CFR). This approach, they believed, would help ensure that States would not only have early access to the requirements but, once they were codified, the requirements would be less subject to change, given the time it takes to revise Federal rules.

Other commenters urged us to publish the data elements in the **Federal Register** at the same time we published the final rule for the purpose of advance notice to the States of the specific data requirements, but they did not recommend that they be a part of the final rule in the CFR.

Response: We agree with the importance of giving States early access to the specific data elements and have published seven appendices, including all data elements and instructions, in today's **Federal Register** along with the final rule.

It was never our intention, however, that these data collection requirements become a part of the rule itself or be codified in the CFR. We believe data collection needs may change over time, in part because the program is a dynamic one and because Congress may modify the reporting requirements. Therefore, we would want to be able to respond to those changes as quickly as possible. Since changes in reporting requirements require Paperwork Reduction Act (PRA) approval, the public is guaranteed an opportunity to comment on any future changes to the TANF Data and Financial Reports as a part of the PRA review process.

Section-by-Section Discussion

Section 265.1—What Does This Part Cover? (§ 275.1 of the NPRM)

This section of the NPRM provided a summary of the contents of this part. We received no substantive comments on this section apart from the general objection to the scope and content of the data collection requirements as a whole.

However, we have made two changes in this section. First, we have deleted paragraph (b)(4) of this section to reflect the elimination of the annual program and performance report. Second, to prevent a misunderstanding that a major purpose of these data collection requirements is research, we have deleted the word ''research'' in paragraph (a) from the term ''section 413 (research and rankings).'' We had included it in the NPRM to fully describe the content of section 413 of the Act. However, we believe it is misleading to reference ''research'' in this context because our research agenda relies, for the most part, on other sources of information.

Section 265.2—What Definitions Apply to This Part? (§ 275.2 of the NPRM)

This section of the NPRM proposed a definition of ''TANF family'' for reporting purposes only and made the definition applicable to both TANF and MOE programs. Our rationale for proposing a definition for reporting purposes was the critical importance of developing comparable data across States, given the fact that, under the TANF statute, a State may develop and use its own definition of ''eligible family'' for program purposes.

In the NPRM, we proposed that information be collected and reported on all persons receiving TANF assistance plus, for any minor child receiving assistance, information on any parent(s) or caretaker relative(s) and minor siblings in the household. We also proposed that information be reported on any person whose income and resources would be counted in determining eligibility for, or the amount of, assistance.

In the preamble to the NPRM, we explained the importance of information on these persons in understanding the effects of TANF on families, the variability among State caseloads, the circumstances that exist in no-parent families, and the paths by which families avoid dependence.

Comments: Two national advocacy organizations supported this proposal. One commented that ''HHS has appropriately defined ''family'' for purposes of data collection requirements to ensure that differences in States' definitions of the assistance unit do not make cross-state comparisons difficult.'' Although commenting on the overall TANF reporting requirements, another national organization found them reasonable and within our authority; it urged that they not be ''watered down.''

On the other hand, many commenters objected to this definition. Commenters expressed particular objection to our proposal to collect information on persons outside the assistance unit or persons not affected by work participation or time-limit requirements. Some commenters asserted that the definition exceeded our statutory authority; others found it intrusive and in conflict with a State's prerogative to define the TANF family. Some States questioned their own legal authority to collect data on nonrecipients and were concerned about possible ethical considerations. Others objected on the grounds of administrative burden, i.e., that such data were not now being collected on these persons, and it would be both costly and burdensome to set up ''a duplicate reporting system'' or require a ''massive modification'' to their present reporting system. One State commented that it appeared this proposal was for evaluation purposes only and claimed that States should not be required to use scarce resources for this purpose.

Some commenters made specific recommendations that conflicted with those of other commenters, as follows:

(1) Allow States to report data based on each State's definition of TANF family;

(2) Limit reporting to persons for whom assistance is provided;

(3) Limit reporting to persons receiving assistance, parents, caretaker relatives and minor siblings, but do not collect data on persons whose income or resources are considered in determining eligibility;

(4) Collect information on persons receiving assistance and persons whose income or resources are counted in determining eligibility, but do not collect information on parents, caretaker relatives, or minor siblings; or

(5) Collect only very limited information on persons not receiving assistance, e.g., information on their relation to the TANF recipient, but no personal data.

Response: We considered these comments carefully in attempting to see how to reduce the reporting burden on States while ensuring that we obtain the necessary and comparable data to meet the requirements of the Act. We have taken the following actions in response to commenter objections:

First, we retain the definition of ''family'' as proposed in the NPRM. For editorial purposes, we have dropped the word ''TANF'' from the proposed term ''TANF family'' in this definition as the term ''family'' is applicable to both the TANF and the separate State programs. However, we are continuing to use the terms ''TANF family'' and ''State MOE family'' in the respective Data Reports, for clarity.

We responded earlier in this section of the preamble to comments that we exceeded our statutory authority in proposing these data collection requirements, including the definition of ''family'' used for reporting purposes. We do not agree that, in creating this definition, we have interfered with a State's prerogative to define ''family'' for program purposes. As we explained in

the preamble to the NPRM, the statute uses various terms to define persons receiving benefits and services under the TANF program, e.g., eligible families, families receiving assistance, and recipients. Unlike the AFDC program, there are no persons who must be served under TANF. Therefore, each State will establish its own definition of ''eligible family.'' These definitions will not be comparable across States, however, and comparable data are necessary to carry out the accountability provisions and other objectives of the Act, e.g., calculating work participation rates.

Second, within the definition of family, we retain all the categories of persons for which we proposed to collect information in the NPRM. However, in response to the various recommendations for elimination or reduction in data collection for these categories of individuals, we have reduced the overall number of data elements and made the reporting of some data elements for certain categories of persons optional. (The State must report all data elements on all persons receiving assistance.) In addition, with the change in the definition of assistance, the burden associated with this reporting may be reduced because it will not generally apply to programs that have traditionally fallen outside the welfare reporting system.

Again, as we explained in the preamble to the NPRM, we believe that information on these additional categories of persons is critical to understanding the effects of TANF on families. For example, we need information on the parents and caretaker relatives (i.e., any adult relatives living in the household and caring for minor children, but not themselves receiving assistance) to understand the circumstances that exist in child-only cases. We need information on minor siblings to understand the impact of ''family cap'' provisions. We also need information on other persons whose income or resources are considered in order to understand the paths by which families avoid dependency. We believe that we have addressed commenters' recommendations for reduced reporting by making many of the data elements optional for these categories of families.

We have added paragraph (e) to § 265.3 to reflect this decision on reporting for other individuals. The Instructions to each Data Report indicate which data elements are optional for which category of person(s).

Comment: In the NPRM, we had proposed that information on the noncustodial parent (NCP) be reported as a part of a family receiving TANF assistance since, under the statute, States may serve NCPs only on that basis. We received a number of comments objecting to, or requesting clarification of, these reporting requirements.

Some States agreed that data should be collected on NCPs; others argued that we lacked statutory authority for this proposal. Some commenters objected to considering NCPs as a part of an assistance unit on the grounds that it complicates both data collection and the State's definition of ''eligible family.''

They asked for clarification of whether reporting information on the NCP meant that the NCP was a member of the TANF-eligible family and if the reporting requirements meant that the family then became a two-parent family. They also asked for clarification of how reporting on NCPs would affect the family for the purpose of meeting work participation or time-limit requirements.

Some States recommended that information on the NCP be reported separately (not as a part of a TANF family); others recommended that we require only an annual aggregated report, e.g., a report containing the number of NCPs who received assistance and the amount of funds expended annually on their assistance.

Response: We believe some clarification of this proposal is needed.

First, regarding the matter of our legal authority, our interpretation of the statute is that TANF ''assistance'' may be provided only to ''eligible families.'' Therefore, States may provide assistance to NCPs only when they are a member of an eligible family. In other words, in order to receive assistance or MOE funded services, the NCP must be associated with an eligible family. We also have the authority to define ''family'' for reporting purposes pursuant to section 411(a)(7) of the Act.

Second, we have added a definition of a NCP in § 260.30. This definition clarifies that the NCP is a parent of a minor child receiving assistance who lives in the State and who does not live in the same household as the child. We adopted this definition based on section 411(a)(4) of the Act, which requires reporting on NCPs ''living in the State'' and to distinguish the NCP from a parent who is living in the household.

If an NCP is related to children in more than one TANF family, the State may decide for which ''eligible family'' the NCP data will be reported. A State should not report information on the NCP in relation to more than one family.

Third, we have provided further clarification regarding NCPs by adding a new paragraph (f) in § 265.3 to specify the three circumstances when a State must report information on a NCP:

- If the NCP is receiving assistance as defined in § 260.31;
- If the NCP is participating in work activities as defined in section 407(d) of the Act; or
- If the NCP has been designated by the State as a member of a family receiving TANF assistance.

See § 265.3 for further discussion of this provision.

Finally, we discuss the questions regarding how the NCP is counted for work participation rate and time-limit requirements in §§ 261.24 (work participation) and 264.1 (time limits).

Section 265.3—What Reports Must the State File on a Quarterly Basis? (§ 275.3 of the NPRM)

In the NPRM, we proposed the specific data collection and reporting requirements for the TANF program and, under certain circumstances, the TANF–MOE (separate State MOE) programs. We proposed a quarterly TANF Data Report, a quarterly TANF–MOE Data Report, and a quarterly TANF Financial Report, or, as applicable, a Territorial Financial Report. We also proposed an annual addendum to the fourth quarter TANF Financial Report that would collect information on the TANF program, such as the State's definition of work activities, and descriptive information on the State's MOE program(s) (by cross-reference to § 273.7).

The NPRM included 11 data-related Appendices. Six of the Appendices contained all of the proposed disaggregated and aggregated data elements and the instructions for filing these data. The proposed reporting requirements applied to families receiving State-funded assistance and families no longer receiving such assistance in both TANF and separate State programs. The other Appendices contained the TANF Financial Report and instructions, sampling specifications, and three statutory reference tables.

As noted in the earlier discussion of comments on the extent of the reporting requirements, we received a mixed reaction to the proposed data collection requirements. A number of commenters supported our general approach and recommended the addition of new data elements, including, for example, requiring States to match participant data with Unemployment Insurance (UI) data in order to obtain better information on persons no longer receiving assistance. Many States and commenters representing State interests,

however, objected to a large number of the proposed requirements.

Commenters frequently provided extensive and detailed comments, including charts and tables as attachments to their letters commenting, in a parallel manner, on each of the data elements in the Appendices. We found these comments, particularly those raising programmatic or administrative concerns, very helpful.

Summary of Changes Made in This Section of the Final Rule

We have made several substantive changes in this section of rule and in the data elements in the appropriate Appendices. In making our decisions, we followed the general principles noted earlier, i.e., to collect the information required by statute; to carry out our responsibilities under the statute to assure accountability and measure success; and to obtain data that are comparable across States and over time.

First, we carefully considered each data element in each data collection instrument. Where possible, we have eliminated, reduced the number of, or simplified the data elements or the break-outs within the data elements. In a few instances, we have modified the data collection instrument to expand a data element. (See the revised TANF Data Report and the SSP–MOE Data Report in Appendices A through C and E through G.) We discuss some of the specific changes and deletions below.

Second, we eliminated the requirement for an Addendum to the fourth quarter TANF Financial Report, but moved the content of the proposed Addendum, in paragraph (c)(2) and (c)(3), to § 265.9—the annual reporting requirements.

Third, we accepted commenters' recommendations to revise our approach to and reduce the burden of the TANF–MOE (now the SSP–MOE) Data Report. We have:

- Reduced the types of separate State programs covered by that report (This was an indirect effect of the changes to the definition of assistance, at § 260.31);
- Retained the requirement for reporting both disaggregated and aggregate data on recipients of assistance under separate State programs under certain circumstances, but have reduced the number of data elements that must be reported;
- Deleted the provision that would have denied a State consideration for a reduction in the penalty for failing to meet the work participation requirements unless data on separate State programs was submitted; and
- Reduced the SSP–MOE data a State must file if it wishes to receive a high performance bonus (by eliminating the requirement to submit section two of the SSP–MOE Data Report, on closed cases). See § 265.3(d)(1).

Fourth, based on the general principles above, we have determined that a State has the option to NOT report some data elements for some individuals in the family. We specify these optional data elements in the instructions to the TANF Data Report and the SSP–MOE Data Report. We have added a new paragraph (e) to § 265.3 to reflect this provision.

Fifth, we added new paragraph (f) to specify the three circumstances when a State must report on a NCP. The three circumstances are:

- When the NCP receives assistance as defined in § 260.31;
- When the NCP participates in work activities, as defined in section 407(d) of the Act, that are funded with Federal TANF funds or State MOE funds; this would include work activities that fall under the definition of ''assistance'' and those that do not; or
- When the State has designated the NCP as a member of a family receiving assistance.

This latter circumstance addresses those States that wish to consider the NCP a member of a family receiving assistance in order to assist the NCP by providing services or other activities that do not meet the definition of assistance in § 260.31 or the definition of work activities in § 261.30. We have included a requirement for reporting on these NCPs in order to obtain data for policy, oversight, and other purposes.

Where a State counts the NCP in calculating the work participation rate, it should reflect its treatment of the family in its coding of three data elements: ''Type of Family for Work Participation Rate Purposes, Work Participation Status, and Work Activities.'' We have added an element in the data instrument to capture such information about NCPs.

Specific Changes Made in the Data Reports

The following changes are subject to review and approval under the Paperwork Reduction Act.

(a) TANF Data Report—Section One—Disaggregated Data on Families Receiving Assistance (Appendix A)

(1) We reduced the number of data elements that must be reported from 106 in the NPRM to 76 in the final rule. Some of the deleted data elements include:

- Four data elements related to child care—Amount of Child Care Disregard, Type of Child Care, Total Monthly Cost of Child Care, and Total Monthly Hours of Child Care Provided During the Reporting Month; and
- Five types of Assistance Provided—Education, Employment Services, Work Subsidies, Other Supportive Services, and Contributions to an Individual Development Account.

Regarding the deleted data elements on child care, in the NPRM, we proposed to collect information required by the Child Care and Development Block Grant Program (CCDBG). Upon further analysis of that statute, we find that the data that must be collected and reported are aggregate data on the number of child care disregards funded by type of child care service provider. Thus, we have made the revised collection of this information a part of the annual report in § 265.9(b)(4).

(2) We further reduced the reporting burden by revising several data elements. For example, in the data element on Sanctions, we deleted the proposed requirement for expenditure data and, in the final rule, ask for a yes/no response. We also collapsed data elements such as the Number of Months Countable Toward Federal Time Limits.

(3) We clarified the definition of ''new applicant'' and clarified reporting on waivers and noncustodial parents.

(4) We provided flexibility in permitting States to report some data elements based either on the reporting month or on the budget month. However, we require the State to be consistent in reporting these data.

In developing the NPRM, we proposed that all data elements be reported based on the ''reporting month.''

However, based on a considerable number of comments and a review of the variation in State practice and State data collection and processing systems, we concluded that, in some cases, information on the budget month would be a good proxy for information on the reporting month. Therefore, the final rule provides that States may report information on five data elements based on either the reporting month or the budget month.

We made this change for data elements that are relatively stable, e.g., amount of Food Stamp assistance and that otherwise might not be reflected in the State data systems. We believe that, as long as States report these data consistently over time, this flexibility in reporting will not compromise the usefulness of the information. We are continuing to require that seven data elements (e.g., amount of assistance) be reported based on the reporting month

because States will have these data elements on that basis.

(5) We simplified or modified certain data elements, e.g., Received Subsidized Housing, Received Food Stamps, Received Subsidized Child Care, Reasons for and Amount of Assistance, Highest Level of Education Attained and Highest Degree, and Citizenship/Alienage.

(6) We revised the data element on Race to comport with the OMB standard for coding multiple race and ethnic information.

(7) We added a new data element to identify families converted to ''child-only'' cases and a new data element to identify a family in which the State provides for the needs of a pregnant woman.

(8) We made technical and editorial changes, e.g., adding coding for some data elements to allow for unknown Social Security Numbers, birth dates, citizenship status, or educational levels; and revised other data elements such as changing the data element on ''Teen Parent'' to ''Parent'' in order to more accurately calculate the two-parent work participation rate.

(9) As noted in our discussion of § 265.2, the instructions also give States the option to not report certain data elements for one or more groups of individuals.

(b) TANF Data Report—Section Two—Disaggregated Data on Closed Cases (Appendix B)

(1) We reduced the number of data elements from 53 in the NPRM to 30 in the final rule, in part by combining several data elements.

(2) We made the same clarifications, modifications, and simplifications in the data elements in this Appendix as we made for the corresponding data elements in Appendix A.

(3) We clarified that States are not expected to track closed cases in order to collect information on families after the family is no longer receiving assistance. States should report the case-record information as of the last month of assistance.

(4) We re-configured the data element on Reasons for Case Closure to add a few break-out categories, partly in response to strong recommendations from commenters. We believe the refinement of these codes will provide better data and significantly increase our understanding of the circumstances of recipients who leave assistance, without increasing the data collection burden.

We understand that many States already collect detailed reasons for case closure, although the information varies across States. Some States are also participating in studies of persons leaving TANF (i.e., ''leavers' '' studies) which will provide information on the circumstances of families after they leave TANF.

In addition, we want to respond more specifically to some commenters' objections to reporting data based on section 411(b) of the Act. (We explained in the NPRM that most of the data elements in Appendix B were based on section 411(b) (annual report to Congress).)

Section 411(b) is specific in requiring information on ''* * * the demographic and financial characteristics of families applying for assistance, families receiving assistance, and families that become ineligible to receive assistance * * *.''

As we said earlier in the preamble discussion to this section, we believe that we have authority to collect data based on section 411(b), and have designed a data collection procedure for closed cases that places minimal burden on States by drawing on the information they have as of the last month the family received assistance. We believe that we have also responded to commenters' concerns by reviewing each data element and reducing by almost one-half the number of data elements in this section of the TANF Data Report.

(c) TANF Data Report—Section Three—Aggregated Data (Appendix C)

We eliminated one data element in this section of the TANF Data Report: Total Number of Minor Child Head-of-Households.

(d) SSP–MOE Data Report—Sections One, Two, and Three—Disaggregated and Aggregated Data (Appendices E, F, and G)

(1) We reduced the total number of data elements in this report from 160 in the NPRM to 108 in the final rule.

(2) Because the data elements in the SSP–MOE Data Report are similar to the data elements in the TANF Data Report, we incorporated into this Report the same clarifications, simplifications, and modifications that we made in the TANF Data Report.

(3) We deleted the proposed requirement that a State must report SSP data if it wants to be considered for a reduction in the penalty for failure to meet work participation requirements.

(4) The final rule narrows the types of separate State MOE programs on which States must report disaggregated and aggregated data. If the State opts to report data on separate State programs, it must report:

- Only on separate State programs for which MOE expenditures are claimed;
- Only on those persons served by separate State programs whose expenditures are claimed as MOE expenditures; and
- Only on separate State programs that provide assistance. (The narrowed definition of assistance at § 260.31 reduces the types of programs subject to reporting.)

(5) We reduced the reporting burden in § 265.3(d)(1)(i) by specifying that, if a State wishes to receive a high performance bonus, it must file only sections one and three of the SSP–MOE Data Report.

Changes Made in the TANF Financial Report (Appendix D)

In the NPRM, we proposed to collect TANF expenditure data in the ACF–196 TANF Financial Report. This reporting form and instructions were in Appendix D. We also proposed an annual addendum to the fourth quarter TANF Financial Report.

As a result of comments received and to clarify some of our policies, we have made several changes in § 265.3(c) and to the ACF–196. One substantive change that we made in response to comments was to delete the requirement that States submit program information as an annual addendum to the TANF Financial Report. These requirements now appear in the annual report described at § 265.9.

We outline the other changes to the ACF–196 TANF Financial Report below:

(1) We have modified the instructions to reflect our clarification about allowable expenditures of carry-over funds and to note the change in SSBG transfer authority (reducing the maximum transfer of 10 percent to 4.25 percent, beginning in FY 2001). This latter change was made by the Transportation Equity Act for the 21st Century, Pub. L. 105–178.

(2) We have added several categories of expenditures on which States must separately report—including transportation (Job Access and other), refundable earned income tax credits, other refundable State and local credits, activities related to purposes three and four of TANF, IDA's, and assistance authorized only on the basis of section 404(a)(2) of the Act. For Other Expenditures (Lines 5d, 6e, and 7), we have asked States to submit footnotes describing what activities are funded under this category.

Also, we have shifted work subsidies from the assistance section of the report to the nonassistance section to reflect our decision to revise the definition of assistance. We include child care and

other supportive services in both sections, and we provide for separate aggregate reporting on transitional services. We have also revised the instructions substantially so that they more clearly identify how States would report particular types of expenditures and they provide some additional guidance on allowable Federal and MOE expenditures.

In general, the additional reporting is designed to give us better information on where States are focusing their resources. We will use this information as part of our strategy to monitor whether expenditures of Federal and States funds are consistent with the purposes of the program and to help identify any policy areas or States that might need further attention. We will also use the data to tell us more about the nature and scope of both TANF programs and separate State programs. State plans and the annual reporting will provide some characteristics information, but the expenditure data are critical for determining where States are focusing their resources. Thus, the data on State spending patterns provide valuable supplemental information about what is happening under welfare reform, and we intend to include summary information from these reports as part of our discussion of State program characteristics in the annual report to Congress.

(3) For State expenditures reported as Administrative Costs in columns (B) and (C), we have changed the language to clarify that the 15-percent administrative cap applies to the cumulative total of (B) and (C) rather than separately to MOE and Separate State Programs.

(4) We have added a statement that States must determine the administrative costs of contract and subcontracts based on the nature or function of the contract.

(5) We have added language to provide that the systems exclusion for tracking and monitoring purposes applies to MOE expenditures as well as the TANF grant. (See prior discussion regarding MOE in the preamble discussion relating to § 263.2.)

The Territorial Financial Report is under development. We are sharing a preliminary version of this Report with the Territories and will be considering their comments before issuing it in final.

Section 265.4—When Are Quarterly Reports Due? (§ 275.4 of the NPRM)

In the NPRM, the language in paragraph (a) of this section reflected the statutory requirement that quarterly data reports are due 45 days after the end of each quarter.

In paragraph (b) of the NPRM, we proposed to give States two options in the timing of the submittal of their TANF–MOE (now SSP–MOE) Data Report.

Paragraph (c) of the NPRM proposed the due dates for the State's initial TANF reports. (Because these are no longer applicable, we have deleted the content of this paragraph from the final rule.)

Comment: Two commenters found it confusing to have ''two due dates for reporting'' in the NPRM. The second due date they referred to was in § 275.8(d). There, we had proposed that we would not impose a penalty for late reporting if a State filed its complete and accurate quarterly report by the end of the quarter immediately following the quarter for which the data were due. (This is a statutory provision found in section 409(a)(2)(B) of the Act.)

Response: For clarity, we have revised the language in paragraphs (a) and (b). With the new language, it is clearer that the statutory due date for the penalty is 45 days after the end of the reporting quarter, but States will not actually incur any penalty liability as long as they submit their reports by the end of the quarter following the reporting quarter.

Although States will incur penalties only if they fail to file their data by the end of the succeeding quarter, we strongly encourage States to submit their reports on the due date. This will provide an opportunity to identify and correct any potential problems or omissions that could otherwise result in a State penalty.

We have made two other changes in this section. First, as noted above, we deleted paragraph (c), as the due dates for the State's initial TANF reports are no longer applicable. Second, we made minor editorial changes in paragraph (b) of the NPRM (regarding timing options for States to submit the SSP–MOE Report) and re-designated it as a new paragraph (c).

Section 265.5—May States Use Sampling? (§ 275.5 of the NPRM)

Most of the comments on this section of the NPRM raised questions about the sampling specifications found in Appendix H of the NPRM.

The statute, in section 411(a)(1)(B)(i), gives States the option of using scientifically acceptable sampling methods to comply with the data collection and reporting requirements of section 411(a). Under section 411(a)(1)(B)(ii), the Secretary must provide the States with case-record sampling specifications and data collection procedures necessary to produce statistically valid estimates of the performance of State TANF programs.

The NPRM at § 275.5(a) specified the option that States have to report data based on sampling or to report data on the entire population (universe) of recipients. In paragraph (a), we also stated that States could use samples to report only disaggregated, not aggregated data. In paragraph (b), we proposed a definition of ''scientifically acceptable sampling method.''

The majority of comments (from more than 25 States and national State-based organizations) urged us to consider greater flexibility in the sampling specifications. In general, they recommended that we:

(1) Eliminate the monthly sample size requirements because they would restrict the State's flexibility provided under the statute;

(2) Allow smaller sample sizes, particularly for smaller States;

(3) Permit States to file some information using sampling and other information using universe reporting; and

(4) Allow States to use alternative sampling methodologies when they can demonstrate that other methods produce equally valid samples.

We disagree with the recommendations to eliminate the monthly sample size requirement but, as discussed below, we have clarified the flexibility States have in designing their sampling plans. We discuss these and other recommendations in the response to comments below.

Comment: Two commenters asked us to confirm that a State can submit universe data if a State does not have enough cases to meet the sample size requirements, e.g., the State does not have 600 two-parent families in its caseload (This was explicitly stated in the instructions to the ETDR, but was not included in the NPRM.)

Response: In the NPRM, we proposed an annual sample size of 600 two-parent families, i.e., an average monthly sample size of 50 two-parent families. We confirm that, if a State has less than 50 two-parent families for a month, the State must report data on all such families.

Comment: In recommending changes to sample sizes, several commenters (i.e., about 10 States) stated that the sample sizes proposed in the NPRM (3,000 annual cases for active cases and 800 annual cases for closed cases for both the TANF and separate State programs) were far in excess of the sample size of 1200 cases that we allowed many States to use under the AFDC-Quality Control (QC) system. The

proposed sample sizes, they believed, would result in a dramatic increase in State data collection workload. For some States, the sample size would equal or exceed the entire caseload.

Commenters also questioned the significance of using the same sample size for large States as for smaller States. Some commenters also objected to the two-parent sample size (600 cases) because two-parent families were a very small percentage of their caseload.

Commenters recommended an overall reduction in sample sizes and/or the use of a finite correction factor that would take into account the size of the caseload in smaller States.

Response: First, in response to the question of the smaller sample size permitted for the AFDC–QC data collection, we believe the differences in these two programs dictate larger sample sizes. The nature of the programs are different and the purpose for which the data are collected is also different.

Under the AFDC program, States had much less flexibility; the major purpose of data collection was focused on determining payment accuracy and charting national trends. Under the TANF program, States have greatly increased flexibility, and data collection is critically important for monitoring and measuring program accountability and program performance.

Second, we agree that a finite population correction factor may be useful, particularly to States with small TANF populations. Thus, we will incorporate this provision in the TANF Sampling Manual.

Third, the recommendations to reduce sample sizes raised more difficult and serious issues. We considered all comments very carefully in evaluating the possible effects of various sample size options. On balance, we are retaining the sample sizes proposed in the NPRM for the reasons discussed below.

In the NPRM (Appendix H, Sampling Specifications), we proposed the following annual minimum required sample sizes:

(1) For families receiving TANF assistance, 3000 families, of which 600 (approximately 25 percent) must be newly approved applicants.

(2) Of the 2400 families that have been receiving TANF assistance, 600 (approximately 25 percent) must be two-parent families.

(3) For families no longer receiving TANF assistance (closed cases), the minimum required sample size is 800 families.

(4) The same sample sizes apply to families receiving assistance and families no longer receiving assistance under separate State programs.

Clearly, reduced sample sizes would increase State flexibility and reduce reporting burden; on the other hand, reduced sample sizes will also reduce the precision of and provide less reliable data for computing State work participation rates.

As we stated in the NPRM, these sample sizes will provide reasonably precise estimates for the overall (i.e., the all-family) and the two-parent work participation rates. The overall rate has a precision of about plus or minus two percentage points at a 95-percent confidence level. The two-parent rate has a precision of about 2.3 percentage points at a 95-percent confidence level. (We could have improved the precision of the two-parent rate to plus or minus two percentage points with an annual sample size of 800 families.) We believe this precision is important to States as the basis for the computation of reliable work participation rates.

In addition, we believe the larger sample sizes are needed to monitor State TANF programs and to enable us to answer key questions of concern to both the Administration and Congress. As we discussed in an earlier section of the preamble, the Secretary is responsible for discerning what is happening at the State level to sub-groups for which we have monitoring responsibility or a major interest, such as child-only cases, sanctioned cases, and immigrants. For example, under a reduced sample size, we would not be able to detect an increase in the percentage of child-only cases until the increase is quite substantial. States could attribute smaller increases to sampling variation.

Furthermore, a smaller sample size hampers our ability to explore the underlying causes of any detected trends. For example, in addition to tracking child-only cases, we might wish to investigate changes in the number of such cases with sanctioned adults in the household. Under the sample sizes proposed in the NPRM, we might be able to study about 150 such families. Using smaller sample sizes, we would be less confident in drawing conclusions based on correspondingly smaller numbers.

We believe that the specific burden and cost of reporting will be different for each State depending on multiple factors. Initial decisions a State must make concern whether to enter the TANF and the SSP–MOE data elements into the State's automated management information system, whether to report these data on a sampling basis, or whether to use a combination of both mechanisms.

For some States, it may be more efficient to automate all data reporting, particularly those States that choose to report universe data. (Currently, 30 States report universe data in their ETDR.) Clearly, as States move to an automated data collection system, the cost and burden of data collection will decline.

For other States, sampling will be the most practicable, efficient, and feasible method. For example, under the sampling specifications in the sampling manual to be issued, the State would select one/twelfth of the minimum annual required sample each month, i.e., approximately 250 cases. (One-twelfth of 3000 is 250.)

Comment: Several commenters also expressed concern that the scope of the proposed data collection was particularly burdensome in light of the changes needed to make State information systems Y2K compliant. They contended that, since States had limited system personnel resources, they could not effectively manage Y2K efforts and major modifications of their systems as a result of final TANF data collection rules at the same time.

Response: Where Y2K problems exist, we suggest that States consider the sampling option in reporting TANF data. (The TANF statute at section 411 provides States with the option of furnishing the disaggregated TANF data via sample. The NPRM provided sampling specifications, and we will be issuing a sampling manual providing States with detailed options.)

With respect to Y2K issues, in general, sampling offers both advantages and disadvantages. On the one hand, the use of samples provides better data (i.e., data that are more readily verified) and uses fewer State and Federal resources. On the other hand, sampled data does not allow States or the Department to track individuals over time. It also does not provide the same precise information on population subgroups within a State, such as child-only cases, or allow matching of TANF recipient data with WtW recipient data. If States use a sample, along with the pc-based software we provide for the creation of their transmission files, they will not need to make major system changes while they work on Y2K problems. In this instance, the use of samples has a number of advantages for a State:

(1) It can devote different personnel resources to conducting samples than to working on the Y2K effort.

(2) It can limit its data collection efforts to the cases or individuals in the sample; it would not have to collect new

information from the entire caseload that it may not find useful or relevant.

(3) Sample information may be more current.

(4) Using a sample, it could extract required information that is already in its computer files and manually collect additional information.

(5) After solving its Y2K problems, a State could reassess whether reporting on a sample basis is still in its best interest.

Even though sampling might make it easier for States to implement the new reporting requirements, we recognize that: (1) the effective date of new reporting requirements comes at a particularly inopportune time for States that have not fully resolved their Y2K issues; and (2) the first responsibility of States is to ensure that their automated systems are capable of maintaining benefits to their neediest citizens. Thus, we have added an additional criterion for reasonable cause at § 262.5(b)(1) related to this issue. Under this new provision, States that miss the deadlines for submitting complete and accurate data for the first two quarters of FY 2000 will receive reasonable cause if: (1) they can clearly demonstrate that their failure was attributable to Y2K compliance activities; and (2) they submit the required data by July 1, 2000.

Comment: Several commenters recommended that States be permitted to report some data based on sampling and other data based on universe data. One State described its TANF program as made up of sub-programs; it wanted the option of reporting sample data on some sub-programs and universe data on others.

However, two States said that we should not allow States to ''mix sample and universe reporting.'' They believed that, in order for data to be meaningful for evaluating policy or performance, States had to use a single method of reporting.

Response: We have decided not to allow a State to submit some disaggregated data based on universe reporting and other data based on sampled information because we do not believe it would be feasible. Not only would it be difficult to analyze such data at the Federal level, it would also be impossible to set up a systematic procedure for estimating totals, proportions, averages, etc., across States. Depending on how fractured the State's reporting is, such mixed reporting might even make within-State estimates impossible. Each data element could have its own weight rather than a weight being associated at the case level.

In addition, States were not in agreement as to what data would be reported on a sample basis and what data would be reported on a 100-percent basis.

Comment: Two States asked us to clarify whether a State could propose the use of an alternate sampling plan as long as it met precision requirements. One State asked for directions on how we will approve the State's sampling methodology.

A few commenters recommended that we allow alternative sampling methodologies when a State could demonstrate that other methods produce equally valid samples. One State, for example, described and recommended approval of a longitudinal sampling design and a rolling-panel design currently in use in its State.

Response: In Appendix H of the NPRM, ''Sampling Specifications,'' we proposed to give States a substantial amount of flexibility in designing sampling plans. In general, we proposed that monthly cross-sectional probability samples be used. Within this broad class of sampling designs, States would have considerable flexibility to formulate their plans. We also suggested that simple random sampling or systematic random sampling design would be easier to implement. However, we did not propose to require that States use one of these designs. We will issue a sampling manual that will incorporate Appendix H, reflect the other decisions in the final rule, and describe, in more detail, the sampling specifications and requirements for States that opt to report based on samples of TANF families and families in separate State programs. Under this TANF Sampling Manual, States will be free to propose other designs for our consideration, as long as their designs reflect cross-sectional monthly probability sampling. We need such samples to calculate monthly work participation rates. We will publish the Sampling Manual in the **Federal Register** and submit it for approval under the Paperwork Reduction Act.

We have added a new paragraph (c) to this section to advise States that they will find the sampling specifications and procedures that they must use in the TANF Sampling Manual.

We reject the specific proposal that we allow longitudinal or rolling-panel designs, primarily because these designs are inappropriate for measuring the work participation rate. These types of study designs predict or reveal the composition of future samples. Thus, a State would know its sample cases for future months and could concentrate on boosting the participation rates of sample cases. In this instance, the sample would no longer be representative of the caseload as a whole and a bias in the resulting estimates would occur. As noted earlier in this discussion, States will be free to propose other sample designs as long as the designs meet cross-sectional monthly probability sampling criteria.

Comment: One commenter recommended that we count sample cases as long as States have sufficient data to satisfy core elements for work participation calculations and make other responses optional.

Response: If a State opts to collect and report data for a sample of families receiving TANF assistance, it must report all section 411(a) data on all families selected into the sample. When samples are used to make estimates about the universe from which the sample was selected, each sample unit has valuable information to contribute to the estimate.

Comment: Two commenters objected to item #4 in the sampling specifications, which proposed that States must submit a monthly list of selected sample cases within 10 days of selection. They stated that this requirement was not in the statute, and it was burdensome on States. They recommended that each State keep a record of the cases pulled and provide a reason for dropping cases, if this occurs.

Response: We need the list of selected cases to ensure that we receive data for all selected cases for each reporting month (i.e., that there are no missing cases). Furthermore, States need such a list for control of their sample. This reporting is not a new requirement; States previously provided such a listing under the AFDC–QC system.

Comment: Two commenters questioned a provision in § 272.3(b)(2) of the NPRM, dealing with ''How will we determine if a State is subject to a penalty?'' This paragraph proposed to prohibit a State from revising its sampling frames or program designations for cases retroactively.

Response: In constructing the sample frame for the reporting month, States must include all families that received assistance for the reporting month through the end of the month. Once the State constructs its frame and selects its sample cases, it would be improper to allow it to redesignate a TANF case as a SSP–MOE case, for example. However, if a family in a sample did not receive assistance for the reporting month, the State would use code (2)—''Listed in error'' under the *Disposition* data element.

Comment: One State commented on sampling and stratification concerns

and recommended that States be allowed different sampling schemes based on local conditions, e.g., different sample sizes for the different monthly strata. It claimed that the proposed sampling specifications effectively created a de facto stratification by month. However, it believed that States gained no advantage by the stratification. Its recommendation, it believed, would be especially helpful for States using monthly samples and would help with work flow and data processing issues.

Response: States have considerable flexibility in designing their sampling plans, including designing strata to accommodate local conditions. Within that flexibility, however, the sampling specifications require that a State select about one-twelfth of the minimum annual sample size each month in the fiscal year. (One-twelfth of 3000 is about 250 families.) This minimum size is important in order to ensure an adequate number of families for calculating a monthly work participation rate, as required by statute.

Comment: One commenter stated that there is no reason, in theory or logic, to assume that systemic random sampling is as good or better than simple random sampling. (The sampling specifications in the NPRM suggested that the former was the preferred approach.)

Response: We had suggested systematic random sampling in the NPRM because most States had used that method in selecting samples for the AFDC–QC program. However, we agree that simple random sampling is an acceptable method for selecting the State's TANF and MOE samples. There are a wide variety of methods that could be used to select monthly samples. These methods include both simple random sampling and stratified random sampling.

Comment: One State suggested that we work with States to develop a more workable approach to sampling. For example, they suggested that it might be useful to permit States to oversample in the first two months of the quarter and undersample in the third month, given the strict requirements for the submission of timely data.

Response: Annual participation rates are based on monthly work participation rate samples. To assure a reliable annual work participation rate, we believe that the samples for each month need to be sufficiently large to calculate a reasonably precise monthly estimate. Therefore, we believe it is reasonable to require States to select 1/12th of its sample each month. Months in which a sample is relatively small (i.e., less than 1/12th the annual required sample size), adversely impact the calculation of the annual work participation rate.

Comment: Two commenters appeared to believe (although we had not specified this in the NPRM) that it was permissible to report aggregate data by sampling, and one commenter recommended that we permit this.

Response: The statute at section 411(a)(1)(B) refers to sampling for disaggregated case-record information. It does not provide specific authority to sample aggregate data. Based on the comments, however, we have determined that it would be appropriate to allow sampling for some aggregate nonexpenditure data elements. (Expenditure data is never reported based on sampling.) We have amended paragraph (a) of this section to reflect this option. We also indicate in the instructions to section three of the TANF Data Report (Appendix C) and section three of the SSP–MOE Data Report (Appendix G) those data elements that may be reported based on sampling.

Section 265.6—Must States File Reports Electronically? (§ 275.6 of the NPRM)

The NPRM proposed to require that States file all quarterly reports electronically, based on format specifications that we would provide.

Comment: We received comments from States and national organizations on this provision.

Several commenters expressed general support for the proposed requirement (e.g., saying "the law does not expressly require electronic reporting, but it will greatly facilitate the analysis of data."), and most States that commented believed that they had the capacity to report electronically.

However, some expressed concern that circumstances might occur that would prevent a State from reporting electronically in a timely manner or would prevent electronic reporting of some, but not all, data. They recommended that the final rule allow alternative reporting methods and give States the flexibility to report data in whatever format is feasible for them, given the varying levels of automation. In addition, a few States commented that they had problems with the current electronic reporting process and software.

Response: As we said in the NPRM, State representatives supported electronic submission of both recipient and financial data in our pre-NPRM external consultation meetings, and we believe all States have electronic reporting capability (as evidenced by their use of electronic reporting under previous programs). We continue to believe that electronic submission of reports will reduce paperwork and administrative costs, be less expensive and time consuming, and be more efficient for both the States and the Federal government.

We would take into account any catastrophic events or one-time-only circumstances that prevented a State from filing its reports electronically, on a timely basis, but we see no reason to change the final rule or give States general authority to submit reports in a variety of formats.

If a State has initial problems in using the reporting processes and software that we will make available, we are committed to working with the State to resolve these problems.

Comment: A few States pointed out that there was no basis in the statute for the electronic reporting requirement. One State recommended that we delete the provision from the rule and issue instructional material separate from the regulations.

Response: We agree that this requirement does not appear in the statute. However, for the reasons stated above, we believe that it will not be an onerous administrative requirement, is programmatically justified, and is within our authority to regulate. Therefore, we have made no change in § 265.6.

Comment: One commenter asked what efforts are underway to ensure compatibility of the proposed software with the many different systems States are using.

Response: As a part of the ETDR, we provided States with a data reporting system, including file layout and transmission specifications. States with a variety of systems and file structures were able to provide the specified data in the format required. We plan to modify this system to capture the data required in the final rule. States will be able to enter data and create transmission files using our pc-based software. It incorporates a free-form capability to help prevent any future system incompatibility problems.

Section 265.7—How Will We Determine If the State Is Meeting the Quarterly Reporting Requirements? (§ 275.7 of the NPRM)

and

Section 265.8—Under What Circumstances Will We Take Action To Impose a Reporting Penalty for Failure To Submit Quarterly and Annual Reports? (§ 275.8 of the NPRM)

We are discussing these two sections together because, as the commenters

pointed out, the proposed penalty provisions in § 275.8 were tied, in part, to the definition of a ''complete and accurate report'' in § 275.7 of the NPRM.

Section 409(a)(2)(A) of the Act provides that the grant of any State that fails to report data under section 411(a) of the Act within 45 days following the end of the fiscal quarter shall be reduced by four percent. However, in accordance with section 409(a)(2)(B), we would not apply this penalty if the State submits the report by the end of the quarter following the quarter for which the data were due. The statute does not specifically address ''complete and accurate.'' We have used these terms to clarify for States what is required in order for a State to be considered to have filed the report required by section 411(a) of the Act.

How Will We Determine if the State Is Meeting a Reporting Requirement? (§ 275.7 of the NPRM)

In this section of the NPRM, we proposed definitions of what would constitute a ''complete and accurate report'' for disaggregated data reports, aggregated data reports, and financial reports, i.e., the TANF Data Report, the TANF–MOE Data Report (now known as the SSP–MOE Data Report), and the TANF Financial Report (and, as applicable, the Territorial Financial Report). We also proposed to review State data to determine if the data met these standards and to use audits and reviews to verify the accuracy of the data filed. We reminded States of the need to maintain records to support all reports filed.

The proposed definition of ''complete and accurate'' was a stringent one. In simple terms, it meant that States must report all elements for all families (or all sample families) with no arithmetical errors or inconsistencies. We proposed to use this definition as a standard against which we would determine if the State was subject to a reporting penalty. For example, we proposed that the data reported to us must accurately reflect the information available to the State; be free from computational errors and internally consistent; be reported for all elements (e.g., no missing data); be provided for all families (universe data) or for all families selected as a part of the sample; and, where estimates are necessary, reflect reasonable methods used by the State to develop its estimates.

We based these proposals on the critical importance of the data and the multiple purposes that the data would serve—the most important of which is meeting the accountability requirements of the statute. We also referred to problems in obtaining complete and accurate data under previous programs and specifically requested additional comments and suggestions on ways to help assure better data, without creating an undue burden on States.

Most of the comments on this issue came from States and national advocacy organizations. Many said that the definition of ''complete and accurate'' was too restrictive; it would be difficult for States to meet both the ''timely'' and the ''complete and accurate'' requirements; 100 percent error-free reporting was unfair (in view of the severe penalty provision) and unrealistic (based on past experience); and the final rule should allow States both a reasonable margin of error and an opportunity to correct or revise their data in appropriate circumstances.

Under What Conditions Will a State Be Subject to a Reporting Penalty for Failure To Submit Quarterly Reports? (§ 275.8 of the NPRM)

In this section of the NPRM, we described the circumstances and conditions under which we would impose a reporting penalty.

We proposed that we would impose the penalty if a State did not file the reports on a timely basis (a statutory requirement) and if the data in the TANF Data Reports and the TANF Financial Reports were not complete and accurate. We specified, however, that the penalty would not apply in several situations:

(1) It would not apply to the TANF–MOE (now the SSP–MOE) Data Report or to the annual program and performance report; and

(2) It would not apply to all data elements.

For example, for disaggregated data on TANF recipients, it would apply only to the data elements in section 411(a) (other than section 411(a)(1)(A)(xii)) and to the nine data elements necessary to carry out a data collection system. For aggregated data, it would apply only to the data elements in section 411(a), the data elements necessary to carry out a data collection system, and those elements necessary to verify and validate the disaggregated data.

We did not specify each step of the penalty process but referred readers to §§ 272.4 through 272.6 of this chapter (now §§ 262.4 through 262.6 of this chapter).

Many commenters appeared to believe that all data elements in all data and financial reports were subject to a penalty and that one missing data element in any one of these reports would trigger an automatic penalty. Others questioned the Secretary's authority to ''penalize States for data not required in the statute.'' Still others appeared to be unaware of the penalty process, e.g., consideration of reasonable cause, submittal of a State's corrective compliance plan, and reduction or recision of the penalty under certain circumstances.

We agree that the language of the NPRM did not provide for flexibility or exceptions. Our intent in proposing these two sections was to define a performance standard for all reports. In addition to the statutory requirement for a timely report, the definition of ''complete and accurate'' would constitute the standard against which we would review the reports submitted; work with States to resolve problems; and, if necessary, move through the steps of the penalty process.

We envision several steps in an implementation process that would lead to full compliance with the data collection and reporting requirements.

(a) Step one: Initial implementation. In the final rule, we have reduced the overall reporting requirements, including the number of data elements, and we have delayed the effective date of the rule to give States additional time to adjust to these reporting requirements. Once States begin to transmit the data specified in the final rule, we anticipate a temporary transition period to work out any problems, but we would hold States to the complete and accurate standard. For example, if States report their data within 45 days of the end of the quarter, as the statute requires, we could have the opportunity to resolve any data problems before the end of the quarter. Thus, submittal by the 45-day deadline could reduce the risk of penalty action against the State.

We would continue the same partnership approach with States that is currently in place to resolve problems that have occurred in the transmission of the ETDR data. We are referring here to nonrecurring and nonsystemic problems such as inadvertent errors, missing data elements, occasional technical glitches, and isolated or unintentional errors.

In addition, we would not prohibit a State from re-transmitting corrected elements in their Data or Financial reports, both during or after a reporting period, as long as retransmission does not become a habitual practice.

(b) Step two: On-going operation. In this step, all States are able to transmit successfully, and most are able to transmit the data generally without errors. We would continue to hold to the complete and accurate standard and