

**DEPARTMENT OF AGRICULTURE****Food and Nutrition Service****7 CFR Parts 210, 215, 220, 225, and 226**

RIN 0584-AC24

**Child and Adult Care Food Program Improving Management and Program Integrity****AGENCY:** Food and Nutrition Service, USDA.**ACTION:** Final rule.

**SUMMARY:** This final rule incorporates into the Child and Adult Care Food Program regulations modifications, clarifications, and technical changes to the two interim rules published by the Department on June 27, 2002 and September 1, 2004. These changes result from over 1,000 public comments received in response to the two interim rules; State agencies' and the Department's experience in implementing the changes in these two rules over several years; and the Department's conduct of an extensive data collection and analysis (the Child Care Assessment Project) designed to evaluate implementation of these two interim rules by family day care home sponsors and providers. This rule clarifies or modifies regulatory provisions relating to: State agency criteria for approving new and renewing institutions' applications; sponsoring organization requirements pertaining to the "block claim" edit check and review averaging; and State- and institution-level requirements pertaining to the serious deficiency process. The changes in this final rule are designed to further improve Program management and integrity and, where possible, to streamline and simplify Program requirements.

**DATES:** *Effective date:* This final rule is effective July 13, 2011.

*Approval date:* The information collection requirements contained in this rule is subject to OMB approval. Once they have been approved, FNS will publish a separate action in the **Federal Register** announcing OMB's approval.

**FOR FURTHER INFORMATION CONTACT:** Ms. Julie Brewer or Ms. Tina Namian at 3101 Park Center Drive, Room 634, Alexandria, VA 22302-1594, or by telephone at (703) 305-2590. A regulatory impact analysis was completed as part of the development of this final rule. Copies of this analysis may be requested from Ms. Brewer or Ms. Namian.

**SUPPLEMENTARY INFORMATION:****Background***Evolution of the Two Interim Rules*

As noted in the **SUMMARY**, USDA has published two interim rules intended to improve Program management and integrity in the Child and Adult Care Food Program (CACFP), at 67 FR 43447 (June 27, 2002) and at 69 FR 53501 (September 1, 2004).

Section 243 of Public Law 106-224, the Agricultural Risk Protection Act of 2000 (ARPA), included a number of nondiscretionary provisions that amended section 17 of the Richard B. Russell National School Lunch Act ((NSLA), 42 U.S.C. 1766). Section 307 of Public Law 106-472, the Grain Standards and Warehouse Act of 2000, further amended one provision in § 17 of the NSLA. These statutory changes were implemented in the CACFP regulations in the first interim rule, published on June 27, 2002. Simultaneously, the Department was working on a second rule. That rule was issued in proposed form on September 12, 2000 (65 FR 55101). In response to State and Federal review findings of mismanagement and Program abuse and to audit findings and recommendations by the Department's Office of Inspector General (OIG), the rule proposed a series of changes to the CACFP regulations. After analyzing 548 public comments on the proposed rule, the Department modified some of its original proposals and published a second interim rule on September 1, 2004, that implemented additional discretionary changes to the CACFP regulations. Taken together, the changes implemented in the two interim rules were designed to improve Program management and accountability in the CACFP while also simplifying other requirements, where possible, in order to offset some of the administrative burden associated with the new requirements in those rules.

**Why is the Department publishing this final rule? Didn't the two interim rules already implement those changes?**

Yes, interim rules have the force and effect of law upon the stated effective date. The changes in these two interim rules are fully implemented. However, the Department anticipated the need to make additional modifications to the provisions of the interim rules, based on Federal, State, and institution experience in operating the Program under the new rules and comments received on the interim rules. To that end, the Department provided an extended comment period for both rules, which gave State agencies and institutions adequate time to fully implement the provisions. In addition,

since the publication of the second interim rule, the Department has undertaken an extensive data collection and analysis, known as the Child Care Assessment Project (CCAP). The CCAP was designed to evaluate implementation of the new regulatory requirements by family day care home sponsors and providers.

During the comment period, the Department provided National training on each of the interim rules and issued extensive guidance designed to address implementation issues. The Department believes that the National training and the guidance it provided have fully addressed a number of the commenters' questions and concerns about the two interim rules. Many of those comments were submitted prior to the provision of the training and the guidance. For that reason, the preamble will not address all of the comments received. The regulatory language set forth at the end of this rulemaking is limited to the changes to the two interim rules being made by this final rule.

**Can you provide a list of the previously-published implementation guidance?**

Yes. In order to help State agencies implement ARPA's provisions and the two interim rules, the Department issued the following guidance:

- July 20, 2000—"Implementing Statutory Changes to the CACFP Mandated by the Agricultural Risk Protection Act of 2000 (Pub. L. 106-224)";
- October 16, 2000—"Monitoring Requirements for Sponsoring Organizations in the CACFP";
- October 17, 2000—Letter to State agency directors on termination of institutions and day care homes;
- April 12, 2001—"Effects of the Agricultural Risk Protection Act, Public Law 106-224, on termination of the agreements of day care home providers in the CACFP";
- March 1, 2002—"Use of 'stop payments' in the CACFP";
- February 21, 2003—"Implementation of Interim Rule: Monitor Staffing Standards in the CACFP";
- January 27, 2004—"CACFP Memorandum #1-04: Sponsor Monitoring Requirements in the CACFP";
- September 1, 2004—"Implementing Changes to the CACFP in Interim Rule entitled, 'Child and Adult Care Food Program: Improving Management and Program Integrity'";
- December 23, 2004—"Additional Guidance on the CACFP Second Interim Rule";

- March 11, 2005—“CACFP Policy #02–05: Collection of Required Enrollment Information by Child Care Centers and Day Care Homes”;
- March 29, 2005—“Transfer of Data Related to the CACFP and the Food Stamp Program”;
- July 1, 2005—“CACFP Policy #03–05: Documenting Reasons for Block Claims by Child Care Centers and Day Care Homes”;
- September 23, 2005—“CACFP Policy #06–2005: Questions and Answers Regarding Institution Applications Regarding Training on the Second Interim Rule”;
- September 23, 2005—“CACFP Policy #07–2005: Conducting a Five-Day Reconciliation in Centers Participating in the CACFP”;
- November 7, 2005—“CACFP Policy #03–2006: Questions and Answers on the Serious Deficiency Process in the CACFP”;
- February 23, 2006—“CACFP Policy #07–2006: Questions and Answers on State Agency Oversight Tools, Sponsor Oversight Tools, and Training and Other Operational Issues in the CACFP”;
- May 23, 2006—“CACFP #12–2006: Issues Relating to Block Claims Submitted by Sponsored Child Care Centers and Family Day Care Homes”;
- January 26, 2007—“CACFP #01–2007: Retention of records relating to institutions, responsible principals or responsible individuals, and family day care homes on the National Disqualified List; retention of records relating to serious deficiencies”; and
- August 27, 2007—“CACFP #15–2007: Documentation of Block Claims Submitted by Sponsored child Care Centers and Family Day Care Homes”.

All of these guidance memorandums are available on the FNS Web site at <http://www.fns.usda.gov/cnd/Care/Regs-Policy/Policy/Memoranda.htm>.

**Can you describe in more detail the CACFP management improvement training provided by the department before and after publication of the two interim rules?**

In the fall and winter of 1999–2000, the Department trained State agencies on management improvement techniques that had been presented in comprehensive management improvement guidance (MIG). In 2001, the Department provided training on FNS Instruction 796–2,<sup>1</sup> revision 3, to State agencies. Training on the MIG and FNS Instruction 796–2 was crucial to addressing the CACFP financial and administrative management problems

that had been uncovered by State and Federal reviewers and auditors.

Finally, after publishing each of the interim rules, the Department developed extensive training related to each specific component of the two interim rules. These training sessions were conducted in 2002–2003 and 2004–2005 at workshops around the country. Staff from each State agency attended the trainings. The curricula and materials for each training session on the interim rules were then re-formatted and distributed to State agencies, so that State agencies could use them to train participating institutions.

**How, if at all, does this final rule differ from the two interim rules?**

This final rule refines the wording of some provisions previously implemented in the two interim rules and the implementation guidance, mostly to clarify regulatory intent, but in several places, to make changes to previous requirements. The preamble discussion will make clear which provisions from the two interim rules have had wording changed for clarification, and which have been changed in a substantive manner.

**In total, how many comments did the department receive on the two interim rules?**

We received a total of 1,009 comment letters or electronic submissions on the two rules—747 on the first interim rule and 262 on the second interim rule.

**Who commented on the rules?**

Of the 1,009 comments received on the two rules: 40 were from State agencies; 448 were from individuals associated with institutions participating in CACFP (either independent centers or sponsoring organizations of homes or centers); 455 were from family day care home providers participating in the Program; 39 were from State or National CACFP or children’s advocacy organizations; and 27 were from parents, students, nutritionists, or other interested individuals whose institutional affiliation could not be determined. In addition, in writing this final rule, the Department also took into account the many comments and suggestions made by participants in the training sessions held in 2002–2003 and 2004–2005.

**What issues raised by commenters will not be addressed in this preamble?**

Because of the extended comment period and the timing of the two interim rules’ publication, some public comments were submitted before the provisions were fully implemented, or

before training on the two interim rules was provided. Therefore, as previously stated, a number of the issues raised by commenters have already been addressed and resolved in guidance or training, and do not require discussion in this preamble.

In addition, the Department received a number of suggestions from commenters concerning the terminology and definitions used in the two interim rules. Although the Department believes that some of these suggestions have merit, we have decided that, in order to avoid confusion, we will not make any changes to terminology in this final rulemaking, unless absolutely necessary to clarify the meaning of specific regulatory terms. The Department may consider making changes to regulatory terminology and format in the future. Readers should assume that provisions from the two interim rules that are not specifically discussed in this rulemaking preamble have not been modified in this final rule. This rulemaking will specifically identify those provisions being clarified or modified in the final rule in order to improve the efficiency or effectiveness of the Program.

**How is the remainder of this preamble organized?**

The preamble is divided into four parts, and is organized in a manner similar to the interim rules published in 2002 and 2004. The four parts of this final rule are as follows:

- I. Institution Eligibility Criteria and State Agency Review and Approval of Institutions’ Applications; the Serious Deficiency Process for Institutions
- II. State Agency and Institution Review and Oversight Requirements;
- III. Training and Other Operational Requirements; and
- IV. Non-Discretionary Changes Required by the Personal Responsibility and Work Opportunities Reconciliation Act, the Healthy Meals Act, and the Goodling Act

**Part I. Institution Eligibility Criteria and State Agency Review and Approval of Institutions’ Applications; the Serious Deficiency Process for Institutions**

*A. Institution Eligibility Criteria and State Agency Review and Approval of Institutions’ Program Applications*

Sections 243(a) and (b) of ARPA added a number of statutory requirements that affected institution eligibility and the institution application process. These changes were designed to improve Program management and integrity by ensuring that the information in an application being submitted by a new or renewing

<sup>1</sup> FNS Instruction 796–2 may be found at <http://www.fns.usda.gov/cnd/care/Management/79-2.pdf>.

institution (*i.e.*, by an independent center or a sponsoring organization of day care homes and/or centers) demonstrates that it is fully capable of administering the Program in accordance with the regulations. These changes not only required institutions to demonstrate their ability to administer the Program, both before they begin operations (in their initial applications) and at certain intervals thereafter (in their renewal applications); they were also intended to ensure that State agencies periodically assess and re-assess each institution's potential ability to perform, based on a thorough review of the institution's Program application.

The Department received public comments on five aspects of the two interim rules relating to basic institution eligibility criteria and the State agency's review of an institution's application to participate in CACFP, as follows:

- The reorganization of the institution application requirements at §§ 226.6(b) and 226.6(f);
- The requirements relating to an institution's documentation of its past performance in the Program application;
- The requirement for all new and renewing institutions to demonstrate "VCA" (financial viability, administrative capability, and accountability) in their Program applications;
- The procedures State agencies must follow when they deny an application submitted by a new or renewing institution; and
- The requirement that several institution principals must submit their dates of birth as part of the institution's Program application.

Comments relating to the last issue—the submission of dates of birth—are addressed in Part III(C) of this preamble. The four remaining issues listed above are addressed in the preamble discussion that follows.

#### (1) Reorganization of the Institution Application Requirements at §§ 226.6(b) and 226.6(f)

The second interim rule reorganized §§ 226.6(b) and 226.6(f), so that § 226.6(b) includes the broad requirements for institution applications and § 226.6(f) specifies the frequency at which an institution is required to update the information contained in its original application. The second interim rule also consolidated or cross-referenced application requirements previously found at §§ 226.6(b), 226.6(f), 226.7(g), 226.15(b), 226.16(b) and 226.23(a) into § 226.6(b), so that State agencies and institutions could more easily refer to them during the application process.

Two commenters stated that the rule was well written, clearly presented and easy to read; seven other commenters felt that § 226.6 was too complex and should be rewritten in a briefer and simpler format. Other commenters made specific suggestions for changes in the terminology used in, or the structure of, § 226.6(b). In addition, forty commenters expressed their concern that the new application criteria were potentially too complex, and might prove to be a barrier to applicants. These commenters recommended that, in order to minimize the potential barrier, State agencies increase their outreach and training efforts and streamline their application processes in the ways permitted by the interim rules.

The Department acknowledges that the structural and other changes made to § 226.6 have added complexity and length to the rule. When adding those new application requirements—many of which were mandated by ARPA—the Department also attempted to find ways to reduce other administrative burdens. For example, the option for State agencies to take renewal applications on a three-year cycle, and to enter into permanent agreements with all types of institutions, will offset some of the administrative burden resulting from the new requirements added in the two interim rules. Furthermore, the current length and structure of this portion of the rules is the result of our more specific delineation of application requirements for new and renewing institutions. If State agencies fully implement these optional provisions, administrative time and effort will be lessened, for them and for institutions. Any further changes to the rule's organization will be considered in the future, and the organization of this section will remain as set forth in the second interim rule.

#### (2) Application Requirements Relating to an Institution's Past Performance

The first interim rule implemented a series of ARPA provisions designed to prohibit institutions and their principals from participating in CACFP if they had been:

- Determined ineligible to participate in any publicly funded program due to violating these programs' requirements;
- Disqualified from CACFP; or
- Convicted of any activity that indicated a lack of business integrity.

In order to fully implement these statutory requirements, the first interim rule required that an institution's application list all publicly funded programs in which the institution and its principals had participated in the past seven years. The rule also required

an institution to certify in its application that neither the institution, nor any of its principals, is ineligible to participate in such programs due to violating those programs' requirements during the seven-year period. In lieu of submitting this certification, the interim rule permitted an institution to submit documentation that the institution or principal previously determined ineligible was later reinstated, or was again eligible to participate in, the publicly funded program, and had paid all debts owed to that program. The rule also required institution applications to include a certification concerning the criminal backgrounds of the institution and its principals.

As part of these certification requirements, the first interim rule included language stating that institutions and principals providing false certifications would be placed on the National Disqualified List (NDL). This language was intended to deter the submission of applications by ineligible institutions and principals, and to provide them with notice regarding the consequences of submitting false certifications. The rule also required that, when reviewing an institution's application, the State agency check the NDL to ensure that the institution is not on the NDL and is, therefore, eligible to participate. Finally, the rule prohibited State agencies from approving an institution's application if the institution or any of its principals had been convicted of any activity indicating a lack of business integrity during the past seven years.

Thirteen comments were received from eleven State agencies and two advocates regarding several aspects of these "past performance" requirements. Two State agency commenters suggested that past performance requirements be eliminated. This cannot be done, since these are statutory requirements. The Department believes that capturing this information on an institution's application is an effective and efficient means of complying with this requirement.

In addition, five State agency commenters made suggestions which they felt would reduce the administrative burden associated with meeting the past performance requirements. One State agency commented that requiring a new institution to list all publicly funded programs in which it participated for the last seven years is burdensome, and that an institution's submission of a "certification of non-disqualification" should suffice. However, the Department believes it is important to require the new institution to submit

both the certification of non-disqualification and the list of publicly funded programs. The certificate of non-disqualification establishes a clear basis for removal from the CACFP (submission of false information) if the institution conceals a prior termination from a publicly funded program. The Department also believes that it is important for the State agency to have a list of publicly funded programs in which the institution previously participated, because it allows the State agency to verify the accuracy of the non-disqualification certification if it chooses.

However, the Department agrees with, and will make, the change suggested by another State agency. The comment suggested that the burden associated with reporting on past performance could be minimized by allowing a renewing institution to include on its application only those new publicly funded programs in which it had begun to participate since its last application was submitted. The Department believes that this suggestion will lower administrative burden while still meeting the intent of the law. Therefore, this regulation will allow a renewing institution to update the list of programs that it submitted in its last application, rather than provide the full list of programs in which it participated for the past seven years. This will minimize unnecessary "re-reporting" of information, which could be especially burdensome for institutions that regularly receive grants or have many other sources of public funding.

Two State agencies commented that an institution should only be required to submit information about programs in which it participated during the past three years, since a three-year record retention requirement is standard in most publicly funded programs. Although the Department agrees that most publicly funded programs require an institution to retain records for a period of three years (or longer if there are outstanding review or audit findings), we do not believe that requiring the principals of an institution to know and document their performance, and the institution's performance, for a seven-year period will pose any special hardship. The principals charged with managing the institution should know the institutions' and all of the principals' record of performance over the past seven years.

One State agency suggested that, if an institution's participation in a publicly funded program has been terminated, and the institution has taken action to correct the deficiency that caused the termination, the State agency should be

able to approve the institution's participation in the CACFP, even if the institution had not been formally "reinstated" to eligibility in the other program. This statutory change ensures that only institutions with records of sound performance in other publicly funded programs be permitted to participate in CACFP. Having the CACFP State agency assess an institution's performance in another publicly funded program does not meet that intent. Only if the institution has been reinstated to participation by the other publicly funded program can the State agency be assured that all corrective actions have been fully implemented, and all debts fully repaid.

Finally, four State agencies and two advocacy groups commented that, if the State agency was required to consult the NDL when reviewing an institution's application, the NDL must be web-based and searchable, and must include all the necessary information concerning institutions, principals, and family day care home providers on the list. The Department agrees that the NDL must be accessible and complete if State agencies are to effectively comply with the regulatory requirement to exclude institutions and individuals who are on the List. To that end, the Department has made the NDL available to State agencies. Although privacy issues initially made it impossible for the Department to provide access to the NDL to institutions, they have been able to obtain the information they need about providers and principals from their State agency, and we anticipate being able to make the NDL directly accessible to institutions in the near future.

Accordingly, the only change made to past performance requirements in this final rule is the modification of § 226.6(b)(2)(iii) to permit renewing institutions to list in their applications only those publicly funded programs in which they have begun to participate since the submission of their last application.

(3) Application Requirements Relating to an Institution's "VCA" (Financial Viability, Administrative Capability, and Internal Controls To Ensure Accountability)

The first interim rule implemented the requirement set forth in section 243(b) of ARPA that, in order to participate, an institution must demonstrate in its Program application that it meets three performance standards now included in section 17(d)(1) of the Richard B. Russell National School Lunch Act (NSLA). These standards require the institution

to be financially viable; to be administratively capable; and to have in place internal controls to ensure the accountability of Program funds and compliance with Program requirements. Sections 226.6(b)(1)(xviii) and 226.6(b)(2)(vii), which were added to the regulations by the first interim rule, require State agencies to evaluate all applicant institutions against these three performance standards, in order to assess their ability to properly administer the Program, and to deny the application of any institution which does not demonstrate conformance with these performance standards or any other requirements set forth in § 226.6(b). In addition, the rule required ongoing compliance with the VCA standards by defining as a serious deficiency a participating institution's "[f]ailure to operate the Program in conformance with the performance standards \* \* \*" (§ 226.6(c)(3)(ii)(C))

A total of 325 comments were received concerning the VCA performance standards. Of these comments, 263 dealt with the requirement at §§ 226.6(b)(1)(xviii)(A)(2) and 226.6(b)(2)(vii)(A)(2) that an institution demonstrate in its application that it has adequate financial resources to operate the CACFP and "adequate sources of funds to withstand temporary interruptions in Program payments and/or fiscal claims against the institution." Many commenters suggested eliminating this language, because they thought that it required family day care home sponsors to pay claims to providers during periods when, for reasons beyond their control, CACFP funding was delayed or unavailable.

The Department understands that, if CACFP reimbursements were temporarily unavailable, few if any sponsors would have the resources to pay provider claims. The regulatory wording was intended to address a different situation, involving the State agency's establishment of an overclaim against an institution, or its denial of a portion of the institution's claim for administrative reimbursement.

Many commenters stated their belief that CACFP is intended to be "self-sufficient"; in other words, they believe that all the resources needed to operate CACFP should come from Program reimbursements. While this belief is largely accurate, there are a number of one-time and recurring expenses for which Program funds may not be used, including the costs of incorporation, the preparation of annual IRS-990 reports, fines and penalties, and some other general business costs. Furthermore, once an institution incurs any

administrative cost, there is always the possibility that the State agency may later determine that the institution's use of Federal funds for that expense is unallowable.

If Program reimbursements have already been used to pay a contractor or supplier for an expense later deemed unallowable by the State agency, the sponsor's repayment cannot come from Program funds, because it is impermissible to use Program funds to repay debts to the government. Therefore, every sponsor must have a source of "non-Program" funds out of which such a claim can be paid. The Department does not expect sponsors to reimburse providers if Federal reimbursement is unavailable. However, a sponsor must still have a source of non-Program funds with which to compensate its employees and pay its suppliers.

In short, if the sponsor does not have a source of non-Program funds in these instances, it runs the risk of going out of business, due to its inability to repay the State agency, or to pay its employees or suppliers. The Department would not advise a State agency to deny an institution's application *solely* because it lacked a source of non-Program revenue. However, the institution itself should be eager to have such funds on hand, since its existence as a viable entity, and its continued ability to provide Program benefits to children, may depend on it.

To further clarify this regulatory language's intent, the Department has made some minor modifications to the wording of §§ 226.6(b)(1)(xviii)(A)(2) and 226.6(b)(2)(vii)(A)(2). The phrase, "has adequate sources of funds to withstand temporary interruptions in Program payments and/or fiscal claims against the institution" has been changed to read, "has adequate sources of funds to continue to pay employees and suppliers during periods of temporary interruptions in Program payments and/or to pay debts when fiscal claims have been assessed against the institution." This language more clearly delineates the situations in which the institution would need to have non-Program funding. In addition, the Department has added to the introductory language at §§ 226.6(b)(1)(xvii) and 226.6(b)(2)(vii) a sentence that reads, "In ensuring compliance with these performance standards, the State agency should use its discretion in determining whether the institution's application, in conjunction with its past performance in CACFP, establishes to the State agency's satisfaction that the institution meets the performance standards."

A related question was submitted by another State agency, which suggested that an institution's budget should only be required to address its planned expenditure of Program reimbursements, not its planned use of non-Program funds. In fact, if the institution does not plan to use non-CACFP funds to support some required CACFP functions, there is no requirement that non-Program funds be addressed in the budget. In that case, the only information needed in the budget or management plan is the institution's source of non-Program funds that could be used to pay overclaims or other costs identified in the preceding paragraph.

However, if the institution plans to use any non-Program resources to meet CACFP requirements, then these funds should be accounted for in the institution's budget. For example, many multi-purpose sponsoring organizations that operate the CACFP devote some non-Program resources to the performance of critical CACFP functions like training or monitoring. Similarly, an independent center may plan to rely on a portion of the parent fees it collects to perform a required CACFP function. In these cases, the institution's budget must account for those non-Program funds that will be devoted to Program administration, so that the State agency has a full understanding of how the institution will fund its performance of all required Program functions.

Accordingly, § 226.7(g) is amended to specify the ways in which "non-program funds" must be addressed in the institution's budget.

In addition, commenters made a number of other suggestions for changing or clarifying various aspects of the performance standards. Forty-seven (47) commenters expressed concern that at-risk afterschool care centers would have great difficulty meeting the performance standards, and should not be held to the same standards as larger Program operators like sponsoring organizations of centers or family day care homes. During our training on the interim rules, we urged State agencies to take into account an institution's size and sophistication when examining different types of organizations' applications. In fact, an entire session of our training on the second interim rule was devoted to a discussion of how State agencies should apply the regulatory language when examining applications submitted by independent child care centers, as opposed to sponsoring organizations of hundreds (or in some cases, thousands) of facilities. We recommend that State agencies apply a "rule of reason" when

reviewing materials submitted by different types of institutions, with different levels of Program reimbursement and, in many cases, different levels of managerial sophistication.

One State agency suggested that sponsored centers, as well as institutions, should be required to demonstrate compliance with the VCA standards. We carefully considered the possibility of requiring sponsored centers to comply with the VCA standards, but ultimately rejected it. Even if a sponsored center has, in the past, operated as an independent center in the CACFP, once a sponsoring organization enters into an agreement with that center, the center becomes a sponsored facility, and assumes a different Program relationship with the State agency. As a result of the rule, a sponsoring organization (not each sponsored center) now has primary responsibility for ensuring that the CACFP is operated in accordance with the performance standards in all of its sponsored facilities. That is why we so strongly recommended in training that State agencies take extra care in evaluating a sponsoring organization's compliance with the performance standards, since the sponsor must be able to demonstrate that it can adequately monitor, train, and provide technical assistance to all of the facilities that it sponsors.

Finally, one other State agency requested that the final rule add a definition of "board of directors" or "governing board of directors." Based on questions we have received since the publication of the first interim rule, and based on the data collected in CCAP, we agree that there is a need for further clarification of the regulatory requirements pertaining to institution boards of directors.

When the first interim rule incorporated performance standards in the CACFP regulations, §§ 226.6(b)(1)(xviii)(C)(1) and 226.6(b)(2)(vii)(C)(1) specified that an institution must demonstrate "adequate oversight of the Program by its governing board of directors." At the time, the Department was reluctant to specify what constitutes "adequate oversight," since many States have their own laws concerning the qualifications, structure, and responsibilities of boards of directors. However, in the years since the first interim rule took effect, the questions submitted to the Department by State agencies and others have convinced us of the need to specifically address two recurring issues concerning boards of directors in this final rule.

First, we have been asked repeatedly how this requirement applies to for-profit centers participating in the CACFP. Although large, publicly-held for-profit corporations have boards of directors, there may be some smaller for-profit entities that do not. In a small, for-profit center, it is quite possible that there will be an owner, but no formally-designated governing board. This rule clarifies this point in a new definition of an “independent governing board of directors”, which will apply to any non-profit or for-profit organization that is required by law to have a board of directors.

Second, we have received numerous questions concerning what constitutes an “independent” governing board of directors. Although some States’ laws define the characteristics of board independence, others do not. Therefore, this rule will delineate the characteristics of “independent governing boards of directors” that are necessary to assure the adequate oversight of CACFP operations. This final rule requires—in a new definition at § 226.2—that an “institution’s governing board of directors” must: (1) Meet on a regular basis; and (2) have the authority to hire and fire the institution’s executive director (*i.e.*, the board must be independent of the executive director’s control).

Based on State agencies’ input and on the information gathered by the CCAP data collection, it appears that some private nonprofit organizations currently participating in CACFP do not have a governing board of directors that fully meets this definition because of lack of independence.” The CCAP assessment determined that 36 percent (18 of 50) of the sponsors assessed included sponsor officials or family members serving on their governing boards of directors. In fact, in almost 20 percent of the sponsors assessed (9 of 46), the board of director’s chairperson was a sponsor official or family member. Although the current regulations do not directly address this aspect of board independence, it is a critical aspect of a board’s ability to provide “adequate oversight of the Program”, as described in the Management Improvement Guidance (MIG). The MIG guidance and training emphasized that governing boards of directors which include the CACFP director, other sponsor officials, and/or members of their families cannot perform the type of independent oversight required for the sponsor’s successful operation of the CACFP. One of the critical hallmarks of a governing board of directors’ independence—the board’s ability to hire and fire the

organization’s executive director—is limited when sponsor officials or their families serve on the board. We encourage State agencies to work closely with institutions participating in CACFP to ensure that such boards are in place, and that this requirement is fully met, as quickly as possible.

Accordingly, this final rule modifies the introductory language to §§ 226.6(b)(1)(xviii) and 226.6(b)(2)(vii), and has made some minor modifications to §§ 226.6(b)(1)(xviii)(A)(2) and 226.6(b)(2)(vii)(A)(2), to clarify the requirement that institutions have “adequate sources of funds” in order to be determined financially viable, as discussed above. In addition, this final rule includes in §§ 226.6(b)(1)(xviii)(C)(1) and 226.6(b)(2)(vii)(C)(1) new language concerning the minimum Program requirements for an “independent board of directors”, and adds to § 226.2 a new definition of “independent board of directors.”

#### (4) State Agencies’ Denial of Institution Applications

The Department received three public comments concerning State agencies’ denial of applications submitted by new or renewing institutions. In addition, we received numerous, detailed questions concerning this subject when we conducted training on the two interim rules.

Two State agency commenters requested a change to the language governing State agencies’ denial of applications. Sections 226.6(c)(1)(i) and 226.6(c)(2)(i) require the State agency to deny an application if it does not meet all of the requirements set forth at §§ 226.6(b), 226.15(b) and 226.16(b). These commenters suggested that this portion of the regulations should instead state that an application is considered incomplete, and that the State agency does not have to formally deny the application, if it does not contain all of the information required by §§ 226.6(b), 226.15(b) and 226.16(b).

The Department cannot agree with this suggested change, because it would prevent some institutions from ever having the opportunity to appeal the State agency’s denial of their applications. If a State agency does not have to deny an “incomplete application”, and no application is considered to be “complete” unless it is approvable, then the State agency will never have to formally deny any institution’s application. While we recognize that it is often necessary for a State agency to request more information from an institution before it can determine whether the institution’s

application is approvable, the process of requesting this information must have an end date, or the institution will, *de facto*, lose its opportunity to appeal the State agency’s action. Likewise, if there is no end to the process of collecting additional information, a renewing institution could continue participating indefinitely while it submits additional information to the State agency.

For these reasons, the Department strongly recommends that State agencies develop written policy governing the maximum amount of time it will take to review an institution’s new or renewal application, including any time for the State agency to request additional information from the institution. If, however, a State agency returns an application to an institution because it was incomplete, and the institution fails to submit more information, the State agency is under no obligation to deny the application. In this instance, by not submitting timely the additional required information, the institution has effectively withdrawn its application from consideration. The only time that the Department would require the State agency to take formal action on an “incomplete application” before the State-established deadline for submitting information is in the rare case where the State agency discovers a serious deficiency when reviewing the institution’s application. In those instances, in accordance with §§ 226.6(c)(1)(i) and 226.6(c)(1)(ii), the State agency would be required to deny the institution’s application and to declare the institution seriously deficient.

Readers of this preamble should note that, although this final rule continues to refer to “renewal applications” at § 226.6(b)(2), enactment of Public Law 111–296, the Healthy, Hunger-Free Kids Act of 2010, made substantial changes to the process by which participating institutions verify their continuing compliance with Program requirements. These changes were addressed in implementing guidance issued on April 8, 2011 (“CACFP 19–2011, “Child Nutrition Reauthorization 2010: CACFP Applications”), as well as in in forthcoming proposed and final rulemaking actions.

#### B. The Serious Deficiency Process for Institutions

Section 243(c) of ARPA added a number of provisions to section 17(d)(5) of the NSLA which modified the serious deficiency process for institutions. As a result, several important aspects of the serious deficiency process were changed in the first interim rule, including: the content of the notice received by an

institution when it is notified that its performance is “seriously deficient;” the time given the institution to correct its serious deficiency and, if the serious deficiency is not corrected, the content of the notice issued by the State agency informing the institution of its intent to terminate and disqualify the institution and those principals and/or individuals responsible for the serious deficiency; and the process for suspending an institution’s Program payments when it has engaged in conduct that poses an imminent threat to children’s, or the public’s, health or safety. In addition, Section 307(c) of the Grain Standards and Warehouse Improvement Act of 2000 (Pub. L. 106–472, November 9, 2000) further amended section 17(d)(5) of the NSLA by prescribing a specific process for suspending an institution’s CACFP participation due to the submission of a false or fraudulent claim. [Note: as used in this preamble, the phrase “serious deficiency process” refers to all actions taken by a State agency after it declares an institution seriously deficient, including the institution’s appeal and its placement on the National Disqualified List (NDL).]

The most significant change to the serious deficiency process made by ARPA was the requirement that, until the conclusion of the appeal process and the termination of its agreement, an institution will continue to receive Program payments for valid claims submitted. Prior to this, a State agency terminated an institution’s agreement and discontinued Program payments at the same time that it declared the institution seriously deficient. Only then did the institution have an opportunity to appeal the State agency’s adverse action. Thus, prior to ARPA, the institution received no Program payments (even if it incurred valid Program costs) until its appeal was resolved, and would then receive payments only if it prevailed on appeal. This approach resulted in two undesirable outcomes: (1) An institution could go out of business while its appeal was pending (due to its inability to pay legitimately-incurred costs), even if it later prevailed on appeal; and (2) many State agencies were reluctant to require an institution to improve program management, since the initiation of the serious deficiency process carried with it the simultaneous termination of the institution’s agreement and the discontinuation of its Program payments.

Part I (B) of this preamble discusses questions about the serious deficiency process for institutions which were raised by commenters and by those who attended the Department’s training on

the two interim rules. As in Part I (A) of this preamble, the training and written guidance provided by the Department have already addressed many of the questions raised. Therefore, this portion of the preamble will discuss only those aspects of the serious deficiency process that require additional clarification, as well as any changes being made in this final rule.

#### (1) General Questions About the Serious Deficiency Process for Institutions

As a result of the statutory changes enacted in ARPA, the first interim rule established more specific requirements governing each stage of the serious deficiency process for institutions, including: the State agency’s issuance of a serious deficiency notice; the amount of time given to an institution for corrective action; the appeal process; the termination of the institution’s agreement; and the placement of the institution and its “responsible principals and individuals” on the NDL. The Department received numerous written comments, as well as questions during its training sessions, regarding these changes to the serious deficiency process for institutions.

Several training attendees raised questions about the maximum amount of time that may elapse between the State agency’s discovery of an institution’s serious deficiency and its issuance of a serious deficiency notice. Attendees also raised a related question: whether an institution can terminate its agreement for convenience after the State agency has discovered a serious deficiency, but prior to the time that the serious deficiency notice is issued.

Once a State agency has discovered a serious deficiency, the first interim rule’s intent was that the serious deficiency process would be completed (*i.e.*, either corrective action would be taken or the institution’s agreement would be terminated), even if the institution terminated its agreement “for convenience” before a formal notice of serious deficiency was issued. The Department anticipated that, once a serious deficiency had been discovered, a State agency would move quickly to issue a serious deficiency notice. Therefore, the first interim rule stated at §§ 226.6(c)(2)(iii)(A)(6) and 226.6(c)(3)(iii)(A)(6) that, after a State agency has issued a notice of serious deficiency, the institution could not voluntarily terminate its agreement as a means of avoiding formal termination “for cause” and placement on the NDL; the serious deficiency process would still proceed. However, during our training on the interim rules, it became apparent that these questions arose

because some State agencies do not, in fact, issue a formal notice for months after discovering the serious deficiency.

In some of these cases, the institution has been told at a review’s “exit conference” that it is seriously deficient. However, if the institution does not promptly receive a formal notice of serious deficiency, the institution may decide that it is preferable to terminate its agreement and withdraw from the Program, rather than go through the serious deficiency process, and possibly be placed on the NDL. Allowing institutions to leave CACFP before correcting their serious deficiencies is very detrimental to the Program, because the institution has neither corrected the serious deficiency nor been placed on the NDL, thus making it more possible for the institution and its responsible principals to re-enter the program later. Without having issued a formal serious deficiency notice which defines the institution’s required corrective action, any State agency’s ability to deny the institution’s future re-application is diminished. In addition, if the issuance of a serious deficiency notice is delayed, the institution may assume that there was, in fact, no real serious deficiency, and no need for the institution to correct its management practices.

For these reasons, it is critical that, once a State agency discovers a serious deficiency, the institution promptly receive formal notice of that finding. By definition, a serious deficiency involves very serious Program management issues. The State agency must take prompt action, including issuing the formal notice of serious deficiency, to ensure that the institution corrects the serious deficiency, or has its agreement terminated for cause, as expeditiously as possible. Furthermore, if prompt action does not occur and the institution subsequently appeals a proposed notice of intent to terminate and disqualify, a hearing official may question the “seriousness” of the deficiency if the State agency took months to issue a written notice.

The Department will not establish in this rule a maximum amount of time for the State agency to issue a serious deficiency. We understand that State agencies have different procedures for handling serious deficiencies. There may be a need for supervisory clearance of a reviewer’s findings and conclusions, and there may be multiple internal clearances of the written serious deficiency notice before it is issued.

However, we strongly encourage State agencies to take steps to minimize the amount of time that elapses between a



review and the issuance of a serious deficiency notice. Such steps might include: Training State reviewers to ensure that they do not exceed their authority in describing findings to an institution during an exit conference; whenever possible, including on a review team a person capable of speaking on behalf of the State agency concerning serious deficiency determinations; and/or establishing internal policies and procedures which ensure that an institution receives timely notice of its serious deficiency. Once these steps are taken, there should be no reason for a State agency to take more than two to six weeks to issue the notice, after the discovery of the serious deficiency.

A second general question raised in training sessions concerned a State agency's determination of which institution employee(s) should be named in a serious deficiency notice (*i.e.*, which persons should be named as "responsible principals and individuals"). Since then, we have observed instances in which either too many or too few principals and individuals were named as responsible. The former approach will slow the appeal process considerably, as hearing officials attempt to discern whether every person named in the notice is truly responsible for the serious deficiency and, therefore, should be disqualified from Program participation. On the other hand, if the State agency fails to name all of the responsible persons in the notice, it increases the risk that these persons (who will not be placed on the NDL) will continue to participate in CACFP as principals in other institutions.

There is, of course, no "magic number" of responsible principals or individuals that should be named in every serious deficiency. The regulations require that, in every instance, both the chairperson of the institution's board of directors, as well as the executive director or other person responsible for CACFP, receive the notice of serious deficiency, as well as any other principals or individuals named as "responsible" for the institution's serious deficiency. Although it is not specifically stated in the regulations, typically the executive director, owner, or other person with overall responsibility for the CACFP within the institution would be named as "responsible" for the institution's serious deficiency. In general, the State agency should name as "responsible principals" those organization officials who, by virtue of their management position, bear responsibility for the institution's serious deficiency. These

management officials also bear responsibility for the poor performance of non-supervisory employees which may have caused the serious deficiency. Non-supervisory employees, including contractors and unpaid staff, should be named "responsible individuals" only when they have been directly involved in egregious acts, such as filing false reports or actively participating with institution principals in a scheme to defraud the Program.

A third general comment made by five State agency commenters was that the first interim rule was burdensome in requiring State agencies to provide FNSROs with a copy of each notice they issued relating to an institution's serious deficiency. The Department included this language in the first interim rule as a means of ensuring that FNSROs would be able to provide State agencies with immediate feedback and technical assistance on the State agency's implementation of the serious deficiency process, and that FNSROs could detect trends across States in the types of regulatory non-compliance leading to determinations of serious deficiency.

Initially, the Department was favorably disposed to reducing this paperwork and requiring only one or two submissions from the State agency to the FNSRO during the course of the serious deficiency process. However, after analyzing the data collected in the CCAP, and after finding a number of flawed State agencies' serious deficiency processes during our conduct of management evaluations, we will not make any change to this aspect of the serious deficiency process. We believe that the most important benefit of maintaining these requirements will be to enable FNSROs to carefully review each document for regulatory compliance as soon as it is issued. If errors are discovered, the FNSRO can then advise the State agency to issue a revised notice to the institution, before the defects of the original notice undermine the State agency's ability to prevail in a later administrative review hearing. Thus, the final rule will make no change to the requirement that the State agency notify its FNSRO at each stage of the serious deficiency process.

Finally, one State agency commenter noted technical errors at 226.6(c)(3)(iii)(B)(1)(ii) and 226.6(c)(3)(iii)(B)(2)(iii), where references to a "renewing" institution should instead read, "participating" institution. Accordingly, this final rule makes the corrections.

(2) The Serious Deficiency Process as it Relates to Applications Submitted by New or Renewing Institutions

The first interim rule added definitions of "new institution" and "renewing institution" to the CACFP regulations, and established new requirements for State agencies' handling of Program applications, as described in Part I(A) of this preamble. A number of attendees at training raised three different questions concerning the interaction of the serious deficiency process and the revised application process. All three of the questions relate to changes made by ARPA to the serious deficiency process. Each statutory change was structured to ensure that an institution be provided with the opportunity for an administrative review ("appeal") before its agreement is terminated and the institution and its responsible principals and individuals are disqualified.

The first question asked whether a new institution could appeal a State agency's denial of its application, if the denial was based on the State agency's determination that either the institution and/or one of its principals is on the NDL. The regulations at §§ 226.6(c)(7)(ii) and 226.6(c)(7)(iv) make clear that no institution which is on the NDL, and no institution having one or more of its principals on the NDL, is eligible to participate in CACFP. Given this requirement, the commenter saw no reason to offer the institution an appeal, since the regulations clearly forbid the institution's participation.

However, the regulations at § 226.6(k)(2)(i) also state that, whenever a new or renewing institution's application is denied, the institution must be given the opportunity to appeal the denial. This is true regardless of whether the new or renewing institution has submitted false information on its application (*e.g.*, a false certification concerning the institution's or principals' eligibility to participate in a publicly funded program), or whether the application included the information that demonstrated the institution's ineligibility (*e.g.*, the applicant stated on the application that the institution or one of its principals was ineligible to participate by virtue of its past performance).

To handle situations like this, the first interim rule established new procedures for an "abbreviated" appeal, as described in § 226.6(k)(9). The abbreviated appeal must be used when the institution appears to be ineligible by virtue of submitting false information on its application or due to any of three types of past performance issues (presence on



the NDL, termination from another publicly-funded program, or conviction for an offense related to business integrity). Consistent with ARPA, the abbreviated appeal ensures that the institution has an opportunity to contest the State agency's adverse action before it occurs, but shortens the appeal process by not permitting oral presentations before a hearing official. The abbreviated appeal gives the institution an opportunity to claim that the State agency had made an error, perhaps by confusing the names of the applicant institution or a principal with another, similarly-named, institution or person. Therefore, any applicant institution—whether new or renewing—must be given the opportunity for a regular or an abbreviated appeal, regardless of the circumstances.

The second question was whether a new institution could evade the potential consequences of a serious deficiency by withdrawing its application for Program participation. Although the regulations at §§ 226.6(c)(2)(iii)(A)(6) and (c)(3)(iii)(A)(6) clearly state that a renewing or participating institution's voluntary termination of its Program agreement does not put an end to the serious deficiency/disqualification process, similar language is lacking with regard to new institutions at § 226.6(c)(1)(iii)(A). The omission of similar language in the first interim rule was an oversight. That oversight is corrected by the addition of a new paragraph in this final rule, at § 226.6(c)(1)(iii)(A)(7), which clarifies that, after receiving a notice of serious deficiency, a new institution may not evade the potential consequences of its serious deficiency by withdrawing its application to participate.

Finally, the third question involves the State agency's conduct of the application or agreement renewal process when either occurs after an institution has been declared seriously deficient. Because all State agencies must require institutions to submit renewal applications no less frequently than every three years, an institution's application must sometimes be renewed while it is in the midst of the serious deficiency process. Similarly, depending on the State agency's policy regarding the duration of a Program agreement, the institution's Program agreement may also expire while it is in the midst of the serious deficiency process. When situations like these have arisen in the past, some State agencies have mistakenly believed that they were required to take no action on a renewal application, or that they were required to deny the institution's renewal

application, because the institution has already been declared seriously deficient. Although these issues have been partially addressed in training and in guidance issued on November 7, 2005 ("CACFP Policy #03–2006: Questions and Answers on the Serious Deficiency Process in the Child and Adult Care Food Program"), they occur often enough to merit further discussion in this preamble, and further clarification in this final rule.

When a renewing institution's agreement expires during the serious deficiency process, the first interim rule at § 226.6(c)(2)(iii)(D)(1) made clear that the State agency must temporarily extend the institution's agreement until the conclusion of the serious deficiency process (whether the "conclusion" of the process comes as a result of successful corrective action, the institution's failure to appeal, or the end of the administrative appeal process). Extending the agreement facilitates continued payment of the valid claims submitted by the renewing institution during the resolution of its serious deficiency. However, the first interim rule did not explicitly state that the same principle would apply to a "participating institution" (*i.e.*, an institution whose serious deficiency is discovered during a review or audit) whose agreement expired while the institution was in the midst of the serious deficiency process. In fact, as with a "renewing institution," the participating institution's agreement must be extended through the conclusion of the serious deficiency process in order to facilitate the payment of valid claims submitted during the serious deficiency process. This final rule will revise § 226.6(c)(3)(iii)(D) to clarify this point.

In the case of a participating institution that is renewing its application during the serious deficiency process State agencies have several options for how to handle the institution's renewal application. First, the State agency may temporarily defer consideration of the renewal application. If the State agency makes this choice, it must continue to pay any valid claims submitted, based on the institution's most recent approved budget (and, in the case of a sponsoring organization, its management plan). Second, the State agency may choose to temporarily approve the institution's budget and/or management plan (provided, of course, that any unallowable costs cited in the serious deficiency notice were handled appropriately in the budget and/or management plan), pending the outcome of corrective action. If the State

agency decides to temporarily approve the institution's budget and/or management plan, the institution would be permitted to provide legitimate cost-of-living increases to employees, and to make purchases approved in the new budget/management plan. In this situation, the State agency must carefully review the institution's renewal application (especially any proposed changes to the institution's budget/management plan) to ensure that the institution will continue to perform all of its required Program responsibilities while it is seriously deficient. In some cases, there may be compelling reasons for the State agency to approve portions of the proposed budget, or even the proposed budget as a whole, especially if the proposed budget shows that the institution will better perform its Program responsibilities by reallocating funds among several budget categories.

However, even if the State agency determines that timely and permanent corrective action was not taken by the institution, and denies the renewal application for that reason, it still needs to extend the institution's agreement and make payments for valid claims, based on the institution's most recent approved budget (and, in the case of a sponsoring organization, its management plan) until any pending administrative appeal is resolved. The most-recently approved budget would be used as the basis for determining claims payments until the end of the serious deficiency process. Therefore, this final rule further revises § 226.6(c)(3)(iii)(D) to clarify that, if a participating institution's renewal application must be submitted during the serious deficiency process, the State agency may either use the most recently-approved budget/management plan as the basis for determining the amount of valid claims to be paid, or it may approve part or all of the institution's proposed renewal budget. Of course, the State agency should only pursue this latter course if it is convinced that the institution will be capable of carrying out all of its Program responsibilities using the proposed budget.

Accordingly, this final rule will add a new paragraph, at § 226.6(c)(1)(iii)(A)(7), which clarifies that, after receiving a notice of serious deficiency, a new institution may not evade the potential consequences of its serious deficiency by withdrawing its application to participate. It also revises § 226.6(c)(3)(iii)(D) to clarify that a participating institution's agreement must be extended through the conclusion of the serious deficiency

process, in order to facilitate the payment of valid claims submitted during the serious deficiency process, and to clarify that, if a participating institution's application must be renewed during the serious deficiency process, the State agency may base valid claim payments on either the institution's most recently-approved budget/management plan or the budget/management plan submitted with the institution's renewal application. Finally, this final rule also revises § 226.6(c)(2)(iii)(D) to make this same clarification regarding the State agency's payment options when a renewing institution is declared seriously deficient.

### (3) Corrective Action

The Department received three questions about the first interim rule's changes regarding a seriously deficient institution's obligation to take corrective action after being declared seriously deficient.

First, one commenter asked the Department to add regulatory language clarifying that an institution may not appeal the State agency's decision that the institution's corrective action is not complete and permanent. The Department agrees, and will add this clarification to the final rule. An institution must have one opportunity to complete corrective action and, failing that, must receive one opportunity to appeal the State agency's notice of intent to terminate and disqualify the institution and its responsible principals and individuals. If, in fact, the State agency errs in determining that the institution's corrective action was unsuccessful, the hearing official will overturn the State agency's notice of intent to terminate. In addition, the institution experiences no adverse effect, since it will continue to receive payment for valid claims submitted during its appeal. Appeal of the notice of intent to terminate and disqualify is the one and only appeal allowed during the serious deficiency process, unless the institution has been suspended (see Part I(B)(xx) of this preamble regarding a "suspension review"). Therefore, § 226.6(k)(3) will be amended to add to the list of actions that may not be appealed the State agency's determination that corrective action was not complete and permanent.

The Department will also act on a request from one State agency commenter and several training attendees that the regulatory language be modified where it states that, if the State agency deems the institution's corrective action permanent and complete, it must "rescind" its notice of

serious deficiency. The intent of the first interim rule was that, if the State agency later discovered that the institution's corrective action was not permanent (e.g., the institution failed to continue taking the actions which the State agency determined were necessary to completely and permanently correct the serious deficiency), the State agency could resume the serious deficiency process for that institution by immediately issuing a notice of intent to terminate and disqualify.

We have learned, however, that the word "rescind" is being interpreted by some hearing officials to preclude the possibility of "re-starting" the same serious deficiency process at the point of issuing a notice of intent to terminate. Instead, hearing officials have sometimes interpreted the word "rescind" to mean that, even if the institution's "corrective action" lasts for only a week, the State agency must begin the entire process over again. This could expose the government to additional loss if, for example, an institution was charging the Program for unallowable administrative expenses.

To rectify this, the Department will remove the word "rescind" at §§ 226.6(c)(1)(iii)(B)(1)(i), 226.6(c)(2)(iii)(B)(1)(i), 226.6(c)(3)(iii)(B)(1)(i), and 226.6(c)(6)(ii)(C)(1) and replace it with the words "temporarily defer." In addition, the Department will add new paragraphs at §§ 226.6(c)(1)(iii)(B)(3), 226.6(c)(2)(iii)(B)(3), 226.6(c)(3)(iii)(B)(3), and 226.6(c)(6)(ii)(C)(3) to state clearly that, if the State agency accepts the institution's corrective action, but later determines that the corrective action was not permanent or complete, the State agency must then move to the next step in the serious deficiency process, without re-starting the serious deficiency process.

Finally, in response to questions raised by training attendees, the Department will also amend the current regulatory language to help ensure that State agencies are able to submit all required information to FNS if an individual has been disqualified and is to be placed on the NDL. The current regulations at §§ 226.6(b)(1)(xv) and 226.6(b)(2)(v) require that, when it applies to participate, an institution's application must include the dates of birth of the executive director and the chairperson of the board of directors. However, in many instances, State agencies are disqualifying additional principals or individuals whose date of birth the State does not possess. The date of birth is the only means by which the Department will later be able to

differentiate between disqualified individuals with the same or similar names. **[Note to readers:** Comments on the requirement to collect the dates of birth of institution officials and of family day care home providers are addressed in Part III of this preamble.]

To facilitate the collection of a date of birth for all responsible principals and individuals, this final rule further amends §§ 226.6(c)(1), 226.6(c)(2), and 226.6(c)(3) by adding new paragraphs §§ 226.6(c)(1)(iii)(A)(8), 226.6(c)(2)(iii)(A)(7), and 226.6(c)(3)(iii)(A)(7) to state that, if the State agency does not possess the date of birth for any individual named as a "responsible principal or individual" in the serious deficiency notice, it must make the submission of that person's date of birth a condition of corrective action for the institution and/or individual. Then, if that person is later disqualified and placed on the NDL, the State agency will be able to forward the person's date of birth to the Department at the time of disqualification.

Accordingly, this final rule will amend § 226.6(k)(3) to add to the list of actions that an institution may not appeal the State agency's determination that corrective action was not complete and permanent. It will also remove the word "rescind" at §§ 226.6(c)(1)(iii)(B)(1)(i), 226.6(c)(2)(iii)(B)(1)(i), 226.6(c)(3)(iii)(B)(1)(i), and 226.6(c)(6)(ii)(C)(1) and replace it with the words "temporarily defer". The final rule also adds new paragraphs at §§ 226.6(c)(1)(iii)(B)(3), 226.6(c)(2)(iii)(B)(3), 226.6(c)(3)(iii)(B)(3), and 226.6(c)(6)(i)(C)(3) to state that, if the State agency accepts the institution's corrective action, but later determines that the corrective action was not permanent or complete, the State agency must then issue a notice of intent to terminate and disqualify the institution and its responsible principals and individuals, without re-starting the serious deficiency process. Finally, the final rule will amend §§ 226.6(c)(1)(iii)(A), 226.6(c)(2)(iii)(A), and 226.6(c)(3)(iii)(A) to state that, if the State agency does not possess the date of birth for any individual named as a "responsible principal or individual" in the serious deficiency notice, it must make submission of that individual's date of birth a condition of corrective action for the institution and/or individual.

### (4) Administrative Reviews ("Appeals")

The Department received ten comments (from nine State agencies and one advocacy group) regarding the

changes made to the institution appeals process in the first interim rule. All of these commenters believed that the 60-day timeframe for completing an institution's appeal (see § 226.6(k)(5)(ix) of the regulations) was too short, and suggested timeframes ranging from 90 to 180 days. Readers of this preamble should note that the 60-day timeframe begins when the State agency receives the institution's request for an appeal, which occurs after the State agency has sent the institution a notice of intent to terminate and disqualify, or has taken another adverse action against the institution, as set forth at § 226.6(k)(2). These commenters were especially concerned that, in States where an agency other than the State agency employs or contracts for the administrative review official, the State agency will be unable to comply with the 60-day timeframe.

The Department understands the difficulties faced by many State agencies in meeting the 60-day timeframe. However, "due process" is prompt process for this purpose. Institutions and responsible principals and individuals should be provided with a resolution of their proposed termination and disqualification as expeditiously as possible in the best interests of the Program. In addition, once an institution's attempt to correct a serious deficiency has been judged inadequate by the State agency, the Department has an obligation to minimize the possibility that public funds will continue to be improperly utilized. Although a State agency is expected to engage in a more meticulous review of an institution's claim once it has been given a notice of intent to terminate and disqualify, there will inevitably be increased risks of improper expenditures during this period. Therefore, this final rule does not alter the 60-day timeframe for completing an institution's appeal.

#### (5) Suspension of an Institution's Program Participation

As previously noted, section 17(d)(5) of the NSLA sets forth a specific process for suspending an institution's CACFP participation based on the institution's knowing submission of a false or fraudulent claim. Thus, although the law establishes procedural safeguards to ensure that institutions continued to receive payment for valid claims submitted, it also clarifies that there are two circumstances under which an institution may be prohibited from receiving Program payments from the outset of the serious deficiency process.

First, ARPA stated that, when an institution's conduct posed an imminent threat to the health or safety

of children or the public (e.g., when a child care center has been cited by State or local health or licensing officials for serious health or safety violations), the State agency *must* suspend the institution's CACFP participation. Second, § 307 the Grain Standards and Warehouse Inspection Act specified that, when a State agency determines that an institution has submitted false or fraudulent claims, it *may* suspend the institution's Program participation, subject to a suspension review that would precede the normal administrative review process. The Department received 11 written comments from State agencies concerning various aspects of the new suspension requirements for institutions.

A number of these commenters asked us to reconsider aspects of implementation that are mandated by law. For example, one State agency commenter recommended that States be permitted to offer a suspension review to institutions that had been suspended due to conduct that posed an imminent threat to public health or safety. However, this is inconsistent with ARPA's intent regarding suspension of an institution for conduct that poses an imminent threat to the health or safety of children or the public. When the State agency suspends an institution for conduct that poses an imminent threat to public health or safety, ARPA permits the institution to have only one appeal. In these circumstances, the institution's single appeal before a hearing official will involve all of the facts surrounding the State agency's suspension action and its notice of intent to terminate and disqualify the institution and its responsible principals and individuals.

Another commenter suggested that there be only one combined appeal of the proposed suspension and the notice of intent to terminate when the reason for suspension was the State agency's determination that the institution had knowingly submitted a false or fraudulent claim. However, in the case of a State agency's proposed suspension of an institution for knowing submission of a false or fraudulent claim, section 17(d)(5)(D)(ii)(II) of the NSLA clearly establishes that the suspension of payments and participation may only occur after a separate suspension review has occurred. In that review, the suspension review official must determine, based on a preponderance of evidence, whether the State agency's proposed suspension was appropriate. Thus, the Department is constrained by the NSLA to maintain the suspension procedures set forth in the first interim rule.

Similarly, another State agency commenter recommended that the Department add additional circumstances (e.g., failure to address review findings, failure to attend mandatory training) under which a State agency would be permitted to suspend an institution's Program participation, including payments. However, this suggestion also contradicts the law. The ARPA specifically limited State agencies' ability to suspend an institution's program payments, prior to the resolution of its appeal, to two circumstances: conduct that poses an imminent threat to children's or the public's health or safety; and the State agency's determination that an institution knowingly submitted a false or fraudulent claim.

Two State agency commenters suggested that the Department lengthen the amount of time permitted by the interim rule during various stages of the suspension review process. The commenters suggested that institutions have 20 days (instead of 10 days, as specified at § 226.6(c)(5)(ii)(B)(5)) to submit materials to a suspension review official, and that suspension review officials have 30 days (instead of 10 days, as specified at § 226.6(c)(5)(ii)(C)(3)) during which to consider their decision to uphold or overturn the State agency's proposed suspension. However, the Department carefully considered these timeframes when developing the first interim rule, and will not modify them in this final rule. Because the institution receiving the suspension review has been suspended due to the State agency's determination that it knowingly submitted a false or fraudulent claim, the Department concluded that it is essential that the proposed suspension be resolved quickly, in order to minimize the institution's possible misuse of additional Program funds.

Two State agency commenters suggested that the first interim rule's requirement for the State agency to "take action" prior to the formal revocation of the institution's license may be unlawful in some States. The Department carefully considered this possibility as well when drafting the first interim rule. That is why § 226.6(c)(5)(i) requires the State agency to take different actions, depending on whether or not State or local licensing or health officials have "cited an institution for serious health or safety violations."

If a citation has been issued by health or licensing officials for conduct posing an "imminent threat" to children's health or safety, the regulations require the State agency immediately to

suspend the institution's CACFP participation. If ARPA had intended CACFP State agencies to wait until an institution's license was revoked, the wording of section 17(d)(5)(C)(ii) of the NSLA would have been meaningless, since unlicensed institutions are ineligible to participate in CACFP. Instead, the law gave the Secretary the authority to write regulations that required "the immediate suspension of operation of the program by an entity \* \* \* , if the State agency determines that there is an imminent threat to the health or safety" of children or the public. We concluded that this wording recognizes a difference between State laws or regulations governing an institution's license to provide child care, and the Department's rules for participation in CACFP. The law expects—and the regulations at § 226.6(c)(5)(i)(B) require—that when an institution is cited by health or licensing officials for an offense that constitutes an "imminent threat" to children's or the public's health or safety, a State agency will immediately declare the institution seriously deficient, suspend the institution's CACFP participation, and provide notice of its intent to terminate and disqualify the institution and its responsible principals and individuals.

However, the Department realized that it might not be appropriate to take the same immediate actions if the State agency, rather than health or licensing officials, had discovered the conditions that might constitute an "imminent threat" to public health or safety. State agency staff are not trained licensurers or health inspectors. For that reason, the first interim rule established a different standard for State agency conduct when the State agency—not the licensing or health department—discovered the potential threat to health and safety. Section 226.6(c)(5)(i) of the first interim rule requires the State agency to "notify the appropriate State or local licensing and health authorities and take action that is consistent with the recommendations and requirements of those authorities." The wording recognizes that, in this circumstance, it may be inadvisable for the State agency to take action related to the institution's CACFP participation until it has conferred with the appropriate health or licensing authorities and obtained their input.

In addition, three State agency commenters recommended that, if a suspension review official upheld the State agency's determination that a sponsoring organization's program payments be suspended for knowing submission of a false claim, the State agency should have the authority to

suspend *all* Program payments, and not just the sponsor's administrative reimbursements. These commenters feared that, if facility meal payments continued to flow through a sponsoring organization that had submitted a false claim, there was a strong possibility that the sponsor would fail to provide full payment to providers, since its own administrative funding had been discontinued.

The first interim rule at § 226.6(c)(5)(ii)(E) required that, when a sponsor was suspended for submission of a false claim, the State agency must "ensure that sponsored facilities continue to receive reimbursement for eligible meals served." This language is based on section 17(d)(5)(D)(ii)(III)(ee) of the NSLA, which requires State agencies to ensure that payments for eligible meals served by facilities continue to be made during the period of their sponsor's suspension. The Department urges State agencies to make meal payments directly to sponsored facilities during the period of their sponsor's suspension, and invites State agencies to contact FNS for guidance in situations like these. However, if there is no other way to provide facilities with earned meal reimbursements than by passing payments through the sponsor, then the law requires these payments to continue. Such circumstances further underscore the need for State hearing officials to provide prompt determinations to CACFP appellants in these cases.

Finally, one State agency requested that the final rule clarify that a suspended institution may still operate, that only CACFP payment is suspended. As the previous discussion makes clear, the program "operation" of an institution must cease as soon as it is suspended, regardless of whether the institution is still licensed to provide child care. For example, if an independent center is suspended based on a licensing citation for an "imminent threat", it will receive no program payments for meals served during the period of suspension, regardless of whether the licensing citation resulted in the State's suspension of the center's license to operate. If an administrative review officer (hearing official) later rules in favor of the institution and overturns the State agency's proposed termination and disqualification, the institution could then submit claims for properly-documented meals served that met meal pattern requirements throughout the period of suspension.

If, on the other hand, a sponsoring organization is suspended for submission of false claims, it will not

receive administrative reimbursement for the period of its suspension. If an administrative review officer (hearing official) later rules in favor of the sponsor and overturns the State agency's proposed termination and disqualification, the sponsor could then submit claims for properly-documented and allowable program administrative costs incurred during the period of suspension.

#### (6) National Disqualified List (NDL)

In the first interim rule, the Department developed new procedures and requirements for a "National Disqualified List", or NDL. These new requirements were designed to ensure that an institution or a day care home which failed to correct its serious deficiencies—as well as any principals and individuals responsible for the institution's or home's serious deficiencies—would not participate in the program for the next seven years (or longer if a Program debt remained unsatisfied). (Note to readers: the serious deficiency process for day care homes is dealt with in Part III of this preamble). The first interim rule also provided that, if an institution or a responsible principal or individual implements corrective action which, in the judgment of both the State agency and FNS, permanently and completely resolved the serious deficiency(ies), the institution or individual could be removed from the NDL. The Department received eight State agency comments concerning the process for placing institutions and responsible principals and individuals on the NDL, and/or for removing them from the NDL after successful corrective action.

Four State agencies commented on various aspects of the process by which an institution may re-enter the Program after having been placed on the NDL. Two of these commenters believed that placement on the NDL should completely remove an institution, responsible principal, or responsible individual's opportunity to re-enter CACFP for a period of seven years. When drafting the regulations to implement ARPA, the Department carefully considered various options regarding the length of time that an institution or responsible principal or individual would remain on the list and what opportunity, if any, they would have to be removed from the NDL. Like these commenters, the Department does not want institutions or responsible principals or individuals to routinely be removed from the NDL prior to the end of the seven-year disqualification period (or longer if they owe a debt to the Program). If such removals were to

become routine, it would partially undermine the premise stated in Part I(B)(3) of the preamble: That the period designated by the State agency for corrective action in its initial notice of serious deficiency provides the institution and its responsible principals and individuals with its primary opportunity to completely and permanently correct its serious deficiencies, prior to having its agreement terminated for cause and being placed on the NDL.

Nevertheless, the Department is also aware that, on occasion, an otherwise capable institution might fail to correct serious deficiencies in a timely manner due to the deficiencies of its current managers. Once these managers are removed from Program participation, it might be possible for the institution's board of directors to re-organize management in a way that would permit the institution to again provide Program benefits to children in a manner consistent with all Program requirements. It must also be stressed, as another State agency commenter noted, that if the institution takes these actions after it has been terminated and disqualified, the institution is in no way "entitled" to again participate in CACFP. The institution would again be required to re-apply for participation as a "new institution," and to meet all of the requirements for approval set forth at § 226.6(b)(1) of the regulations. The State agency must consider the institution's entire application and must find that the institution is fully capable of operating the Program in accordance with all requirements. It is possible that the institution's correction of its prior serious deficiencies will not, by itself, make its new application to participate approvable.

In addition, another State agency commenter requested that the Department emphasize that the decision to remove an institution or a responsible principal or individual from the NDL is a two-part process. The State must first determine that the corrective action taken after placement on the NDL has completely and permanently corrected the serious deficiencies that led to the disqualification. Then, FNS must concur with the State agency's decision. Furthermore, once an institution or a responsible principal or individual is placed on the NDL, it has forfeited its right to appeal the State agency or FNS's decision that its corrective action is inadequate. To underscore this point, this final rule will further amend § 226.6(k)(3) to clarify that an institution may not appeal the State agency's or FNS's determination that its corrective

action is insufficient to justify removal from the NDL.

Another State agency commenter requested that the final regulation include stronger language to clarify the State agency's responsibility when an institution on the NDL submits an application to participate. In this situation, the State agency has only one responsibility: to determine whether the institution knowingly submitted false information on its application (in which case, consistent with § 226.6(c)(1), the State agency must initiate a serious deficiency process with an abbreviated appeal, so that the expiration of the institution's seven-year disqualification can be extended). Otherwise, the State agency may simply return the application, stating that the institution is not eligible to have its application considered until it has been removed from the NDL. To underscore this point, this final rule further amends § 226.6(k)(3) to state that an institution on the NDL may not appeal the State agency's refusal to consider its application to participate until the institution has been removed from the NDL, nor may an institution appeal if the State agency refuses to consider an application submitted on behalf of a sponsored facility that is on the NDL.

Finally, this final rule amends §§ 226.6(b)(1)(xii), 226.6(b)(2)(ii), and 226.6(c)(7) to modify current regulatory language stating that the State agency must "deny the application" of an institution or sponsored facility on the NDL, and that such institution "may not submit" an application for itself or on behalf of a sponsored facility on the NDL. Several State agency commenters correctly noted that it is impossible to prohibit any entity from "submitting" an application. The changes to the regulatory wording we are making in this final rule will more appropriately focus on the State agency's responsibility to not approve the application, and the institution's absence of appeal rights, in this circumstance.

Accordingly, this final rule further amends § 226.6(k)(3) by adding § 226.6(k)(3)(vi) to state that an institution may not appeal the State agency or FNS's decision that an institution's corrective action is inadequate to be removed from the NDL, and by adding § 226.6(k)(3)(vii) to state that an institution on the NDL may not appeal the State agency's refusal to consider an application to participate until it, or a sponsored facility on whose behalf the institution has applied, has been removed from the NDL. In addition, this final rule amends §§ 226.6(b)(1)(xii), 226.6(b)(2)(ii), and

226.6(c)(7) to modify current regulatory language stating that the State agency must "deny the application" of an institution or facility on the NDL, and that such institution and facility "may not submit" an application. Instead, the regulatory language will be amended to state that the State agency may not approve an application submitted by an institution on the NDL, or an application submitted by an institution on behalf of a sponsored facility that is on the NDL, and that a State agency's refusal to consider an application in this circumstance is not subject to administrative review.

## Part II. State Agency and Institution Review and Oversight Requirements

### Introduction

Sections 243(a) and (b) of ARPA added three statutory requirements which affected the regulatory requirements for State agency monitoring of institutions and sponsoring organizations' monitoring of their sponsored facilities. These changes were designed to improve Program management and integrity by strengthening the requirements affecting the review and oversight functions performed by State agencies and sponsoring organizations participating in the CACFP. These three changes were discussed in Part II of the interim rule published on June 27, 2002, which implemented all of the changes mandated by ARPA in the CACFP regulations.

In addition, a number of additional regulatory changes affecting State agency and sponsor monitoring and oversight were suggested by the "Operation Kiddie Care" report, issued by the United States Department of Agriculture's Office of Inspector General (OIG) in August of 1999. On September 12, 2000, the Department issued a proposed rule that addressed most of the changes to review and oversight requirements suggested in the Kiddie Care report. After analyzing public comments on this proposed rule, the Department published a second interim rule on September 1, 2004, which implemented these changes to State and sponsor review and oversight requirements in the CACFP regulations. These changes were addressed in Part II of the second interim rule, published on September 1, 2004.

In total, the two interim rules addressed twelve different aspects of CACFP review and oversight requirements, as follows:

- Unannounced reviews conducted by sponsoring organizations and State agencies;

- The minimum number of sponsor organization staff devoted to performance of the monitoring function;
- The frequency of State agency reviews of institutions (referred to as “the State agency review cycle”);
- Enrollment form requirements for children participating in CACFP facilities;
- The minimum content of State agency reviews of institutions (referred to as “State agency review elements”);
- The minimum content of sponsor reviews of facilities (referred to as “sponsoring organization review elements”);
- Requirements for monthly State agency and sponsoring organization edit checks of meal claims submitted by institutions and facilities;
- Requirements for sponsoring organizations and State agencies to conduct “household contacts” to the families of children participating in CACFP;
- The frequency of facility reviews conducted by sponsoring organizations (referred to as “the sponsoring organization review cycle”);
- State agency disallowance of fraudulent or otherwise unlawful facility meal claims;
- The rules governing audits of institutions participating in CACFP; and
- Requirements concerning family day care home providers who qualify for tier I reimbursements on the basis of their receipt of benefits under the Supplemental Nutrition Assistance Program (SNAP), formerly known as the Food Stamp Program.

The Department received public comments on all but two of the above items: State agency disallowance of fraudulent or otherwise unlawful facility meal claims, and the changes to the Department’s rules governing audits at 7 CFR Part 3052. On several other items, comments focused solely on one aspect of the new requirements (*e.g.*, all comments concerning edit checks had to do with the Department’s requirement that sponsoring organizations implement an edit check that would identify “block claims” submitted by their facilities). As in Part I of this preamble, a number of the issues raised by commenters have already been addressed in guidance or training, and do not require extensive discussion in this preamble.

#### A. Unannounced Reviews

Prior to the issuance of the first interim rule, the CACFP regulations required that most sponsoring organizations make three reviews of each of their facilities each year, but did not specify whether these reviews

should be announced or unannounced. Common practice, prior to the first interim rule, was to make most provider reviews announced (*i.e.*, the sponsor would schedule the review with the provider in advance). However, the OIG’s “Operation Kiddie Care” report strongly recommended that sponsor reviews be unannounced, and Section 243(b)(2) of ARPA amended section 17(d)(2) of the NSLA by requiring that some State agency and sponsor reviews be unannounced. Consequently, the first interim rule continued to require that each sponsor conduct three reviews per facility per year, but added the requirements that two of the three reviews be unannounced, and that one of the unannounced reviews include a review of a meal service. The first interim rule encouraged State agencies to conduct unannounced reviews of problem-prone institutions, and required that, when conducting a review of a sponsoring organization, at least 15 percent of the facility reviews conducted by State agency staff must be unannounced.

Furthermore, the rule established certain requirements for notifying facilities of these new requirements, and for sponsor staff to have photo identification—to demonstrate that they are sponsor employees—when conducting unannounced reviews. Finally, in response to sponsor concerns that unannounced reviews would increase costs due to a provider’s absence at the time of the review, the Department also added a requirement that providers must notify sponsors in advance whenever the provider planned to be out of the home with the children in care during a scheduled period of meal service.

The Department received 366 comments regarding the required frequency of unannounced sponsor reviews of facilities. Of these, 320 were from family day care home providers, 37 from institutions, four from State agencies, four from advocacy groups, and one with no identifiable affiliation. Twelve (12) commenters supported the provision as written. The remaining commenters offered a wide variety of alternative suggestions for the frequency with which unannounced reviews must be conducted. The most common alternative suggested (by 306 commenters) was that the Department should require one unannounced and two announced reviews of each facility each year. Seventeen providers opposed any requirement that sponsors conduct unannounced reviews, while the remaining 31 commenters suggested ways in which the Department could either lower the total number of

required reviews below three per year and/or permit sponsors to focus more reviews on providers with suspicious claiming patterns.

Based on the results of the CCAP, the Department remains convinced that the requirement for two unannounced reviews per facility per year is appropriate. The results of the CCAP report suggested that, although there has been improvement in some areas of program management following publication of the two interim rules, significant problems still remain with regard to the accuracy of family day care home provider meal counts. There are two CCAP findings which relate directly to this issue. First, of all visits completed during CCAP, over one-fourth of providers’ meal and/or menu records were not up-to-date at the time of the assessment team’s visit. Unfortunately, this problem was not confined to particular sponsors: for over 80 percent of the sponsors assessed, more than 20 percent of homes lacked up-to-date meal and/or menu records on the day of the CCAP assessment. Second, on other days of the month in which the CCAP was conducted, more than 40 percent of providers’ meal counts were, on average, one or more meals higher than the number of meals observed for the same meal service on the day of the assessment team’s visit.

While these findings do not prove the existence or frequency of misreporting on provider claims, taken together, they suggest that meal count integrity is in need of improvement among family day care homes participating in CACFP. Unannounced sponsor reviews should be an excellent tool for identifying these issues. Therefore, the rule continues to require that two unannounced reviews must be made to each facility each year, as set forth in the first interim rule. In addition, as discussed further in Part II(H), commenters should note that the second interim rule did provide a new approach to “review averaging,” which provides sponsoring organizations with greater flexibility to focus their review efforts on new or “problem” facilities.

In addition, the Department received 671 comments concerning the requirement that providers notify sponsors in advance whenever the provider planned to be claim a meal served outside of the home to children in care during a scheduled period of meal service. A total of 278 comments (from 240 institutions, 22 advocates, one provider, four State agencies, and 11 commenters with no clear affiliation) recommended that the requirement be made optional, at the discretion of the sponsoring organization. Some of the sponsor commenters felt that they

already had reasonable provider “call-in” requirements in place, and that such requirements needed to be individualized for each sponsor. A total of 386 other commenters (361 providers, 16 institutions, one State agency, one advocacy group, and seven with no organizational affiliation) were opposed to the requirement, and believed it should not be addressed at all in the Federal regulations governing CACFP. These commenters felt it would be difficult for providers to remember the requirement when they were preparing the children to leave the home.

The Department wishes to correct a misunderstanding that has frequently been expressed about this requirement—namely, that it requires a CACFP provider to call the sponsor any time she leaves her home with the children in her care. In fact, providers are required to contact the sponsor only if they plan to be out of the home during a scheduled meal service. This provision was promulgated as a way to address the issue of inflated meal counts. Often, sponsors would report that their unannounced visits were unsuccessful because providers were not at home during the specified time of meal service. These same providers would often claim that reimbursable meals were served at another location (e.g., a nearby park) during the same time of meal service. Sponsors were frustrated by their inability to address suspicious meal claims in these circumstances.

Thus, the regulatory language that required providers to notify the sponsor when they would be out of the home and provide a reimbursable meal to enrolled children was intended to give sponsors the clear authority to disallow meal claims when the provider had not given such notification. In addition, it was hoped that the call-in requirement would minimize sponsors’ costs in instances where sponsor monitors had to travel a great distance to conduct an unannounced review, and where providers were so geographically dispersed that the monitor might find it difficult to return to an absent provider’s home on the same day. Removing the call-in requirement would impair our ongoing efforts to improve the integrity of provider meal counts, and might place a special hardship on sponsors of day care homes that are widely dispersed and located in rural areas.

#### *B. Sponsoring Organization Monitoring Staff (“Monitor-Staff Ratio”)*

Section 243(a)(8) of ARPA amended section 17(a)(6) of the NSLA to require that, in order to be eligible to participate

in CACFP, a sponsoring organization must employ an appropriate number of monitoring staff, based on the number and type of facilities it sponsors. Based on that statutory language, the first interim rule established different ratios of facilities to full-time monitor staff that sponsors of homes or centers must employ. The rule provided a range of facilities (50 to 150 for day care homes, 25 to 150 for sponsored centers) which the State agency could use in determining whether the sponsor’s management plan documented employment of enough staff to properly monitor the number and type of homes it administered. Establishing ranges was intended to provide State agencies with the flexibility to take into account such factors as whether the sponsor’s facilities were rural or urban, the facilities’ geographic dispersion, and the monitors’ proximity to the facilities. It is the Department’s understanding that few if any State agencies have taken advantage of this opportunity to “customize” the staff-monitor ratio for sponsors with differing circumstances, opting instead to determine only whether the sponsoring organization’s management plan documents that the sponsor meets or exceeds the ratio of one full-time equivalent monitor for each 150 facilities administered. The Department required sponsors to comply by July 29, 2003, one year after the effective date of the first interim rule, but later extended the deadline to October 1, 2003.

A total of 772 comments (including multiple comments about different aspects of this requirement) were received from 435 institutions, 298 providers, 17 State agencies, 8 advocates, and 14 others with no clear organizational affiliation. One group of 240 respondents focused their comments on the numerical range of facilities (50–150 homes or 25–150 centers) for which § 226.16(b)(1) requires a sponsor to employ one “full-time equivalent” staff. These commenters suggested that the high end of the range of facilities per monitor should be raised (to 200, 250, or even 300), that the requirement should be abolished, or that the rule should only be applied “for cause,” when sponsoring organizations were found to have serious monitoring problems.

The regulatory requirement cannot be abolished, since it is based on the previously-mentioned statutory language describing the minimum requirements for sponsor eligibility. The Department has concluded that this provision is not restricted to sponsors with documented monitoring problems. The provision’s greatest value may be to

prevent the development of serious monitoring problems, by ensuring that each sponsor devotes adequate human resources to the monitoring function.

Furthermore, we are concerned that many of these comments may have been developed without benefit of the information provided in the extensive implementation guidance for this provision that was issued on February 21, 2003. That guidance established procedures for State agencies to use to request a waiver for the upper limit of facilities per monitor, if the State agency determined that a sponsor that did not meet the upper limit was effectively monitoring and managing the CACFP, and was already devoting a reasonable portion of its budget to monitoring. The Department implemented this waiver policy well before the monitor-staff requirements became effective on October 1, 2003, but has not received any requests for waivers. A second group of 259 comments focused on the methods State agencies must use to calculate whether a sponsor employs sufficient staff to meet the monitor-staff standards specified at § 226.16(b) of the regulations. Of these, 226 commenters reminded the Department that staff persons with the title of “monitor” also perform other functions, and that these functions should also be counted towards the sponsor’s fulfillment of the monitor-facility ratio.

This issue was thoroughly addressed in the guidance issued by the Department on February 21, 2003. It clarified that not every duty performed by an employee with the title of “monitor” is monitoring-related, but that monitoring-related functions performed by any employee, regardless of title, should be counted towards the sponsor’s number of full-time monitoring equivalents. For example, that portion of clerical staff time devoted to the preparation of monitoring-related correspondence, or that portion of supervisory staff time dedicated to quality control or other oversight of monitors and reviews, should also be counted in calculating the sponsor’s full-time monitoring equivalents. The 2003 guidance contained a list of the tasks that should and should not be counted as “monitoring-related,” and readers are urged to consult this guidance whenever questions arise.

Another group of commenters questioned the number of hours that the Department used in estimating the time necessary to perform three reviews for one facility over the course of a year. In the preamble to the first interim rule, the Department estimated that a sponsor would need to devote 12 to 15 hours per



facility to conduct all monitoring-related activities for that facility. Thirty-three commenters stated that the Department had greatly overestimated the amount of time spent by monitors on a typical review. However, as explained in the 2003 guidance, that per-facility estimate included not only the time a reviewer spends conducting three onsite reviews (adjusted upward to account for new regulatory requirements such as unannounced reviews, five-day reconciliations, annual enrollment updates, and other monitoring-related functions), but also all of the other aspects of the monitoring process, including travel time, planning, follow-up report writing, the time needed to conduct household contacts and, if necessary, the time required to conduct the serious deficiency process established for day care homes in the first interim rule.

Finally, 273 providers submitted comments questioning why the Department was “micro-managing” sponsors’ program management. The Department implemented a statutory requirement that a sponsor employ adequate staff to perform all of the monitoring-related activities that are now required following publication of the two interim rules. Responsibility for the implementation is not, therefore, “micro-managing”. These commenters are also reminded that ARPA required the Department to establish a method of determining whether sponsors employed enough staff to perform adequate monitoring, taking into account the number and type of facilities in which the sponsor administered the Program. The Department chose this particular approach after considering a number of other alternatives, as fully explained in the preamble to the first interim rule.

#### C. State Agency Review Cycle

Section 243(b)(2) of ARPA amended the requirements at section 17(d)(2) of the NSLA for State agency reviews of institutions (*i.e.*, independent centers and sponsoring organizations). Prior to ARPA, State agencies were required to review all institutions no less than once every four years. As a result of the change made by ARPA, State agencies were required to review each institution no less frequently than once every three years, in order to “identify and prevent management deficiencies and fraud and abuse under the Program.”

The Department implemented these required changes at § 226.6(m)(4) of the first interim rule. In addition, consistent with the amendment’s requirement to identify and prevent fraud and abuse, the Department added a requirement at

§ 226.6(m)(2) that, in establishing its review priorities, State agencies must target for more frequent review those institutions in which the prior review had included a finding of serious deficiency. Finally, the Department elected to modify one other aspect of the former State agency review requirements in the first interim rule, by requiring that all sponsors of more than 100 facilities (the threshold had previously been 200 facilities) be reviewed by the State agency no less than every other year.

The Department received five comments on these changes, four from State agencies and one from an advocacy group. Three commenters believed that State agencies would be unable to increase their reviews from once every four years to once every three years. However, this change was required by ARPA, and may only be altered by amendment to Federal law. Two other commenters believed that, in order to meet the amendment’s minimum requirements, the Department should simply require that each State agency review one-third of all participating institutions each year. Although this would provide a simple way of meeting the law’s numerical requirements for institution reviews, the Department strongly believes that the large percentage of Program expenses utilized by sponsors of over 100 facilities justifies the requirement that State agencies review them every other year.

#### D. Updating Children’s Enrollment in CACFP and Other Enrollment-Related Requirements

The CACFP regulations have always required that, in order for meals to be reimbursed under the Program, the children receiving the meals must be “enrolled for child care” in a day care facility that meets the licensing or approval requirements set forth at § 226.6(d) of the regulations. Prior to the publication of the Kiddie Care report, the frequency of collecting enrollment forms and the content of those forms were not addressed in the regulations. Enrollment requirements were established by each State’s licensing agency, and thus were specific to each State.

Although these State licensing requirements for children’s enrollment remain in effect, the findings of the Kiddie Care audits showed that, in order to ensure the integrity of Program funds, the Department needed to establish CACFP-specific enrollment requirements that established minimum requirements for all States. Specifically, the Kiddie Care audits uncovered

instances in which enrolled children were being claimed for meal reimbursement long after the child had left the CACFP facility. To address these improper claims, OIG recommended that the Department establish requirements regarding the updating and content of children’s enrollment forms.

In response, the second interim rule established the requirement that children’s enrollment forms must be updated annually, and that the form must be signed by a parent or guardian. These changes were primarily made to help sponsor monitors, quickly identify “old” enrollments for children no longer in care, and to reduce the number of improperly claimed meals by having parents or guardians annually update the form.

In addition, the second interim rule required that the enrollment form indicate each child’s days and hours of care and the meals the child normally receives while in care. For example, a toddler in care might normally be present five days a week and receive breakfast, lunch, and an AM snack each day, whereas a child attending a pre-kindergarten program would normally have different hours and receive different meals for those days on which he/she attended preschool. School-age children would usually have the same schedule of care every day, but might normally be in care only after school and receive a PM snack only. Requiring that the enrollment form include information on each child’s normal days and hours of care and the meals he/she received was intended to help sponsors determine the validity of facility claims, and especially to assist sponsor monitors in conducting five-day reconciliations, which the second interim rule required to be conducted as a part of each facility review (see Part II(E) of this preamble).

To facilitate this provision’s implementation, the Department included several accommodating provisions in the second interim rule and in guidance. First, to accommodate larger sponsors (some of which handle many thousands of enrollment forms every year), full implementation of this requirement was delayed until April 1, 2005, so that sponsors could phase in the requirement over a period of time. This delay permitted larger sponsors to “stagger” the end date of enrollments and to spread their enrollment workload over a longer period of time. In addition, although new enrollment forms collected on or after April 1, 2005 were required to comply, the Department permitted the enrollments of then currently-participating children to be

updated later (by no later than September 30, 2005).

Second, in response to concerns from States in which only the State licensing agency could make changes to the State-required enrollment form, the delayed implementation gave State agencies more time to coordinate with their counterparts in the State licensing agency concerning these changes. In addition, if it proved impossible for State licensing to effect these changes by the required deadline, guidance issued with the second interim rule provided State agencies with the option of capturing this "enrollment" information on a CACFP income eligibility form.

Third, in response to concerns expressed by State agencies in States where parents were required by licensing to sign children in and out of care each day, the Department issued guidance on March 11, 2005, which relieved such States of the requirement to collect each child's days and hours of care on the enrollment form, since the child's presence or absence at the facility is clearly documented on the sign-in/sign-out sheet. Finally, recognizing that not all States require enrollment for children in all types of facilities that participate in CACFP, the second interim rule exempted outside-school-hours care centers, at-risk afterschool snack programs, and emergency shelters from the child enrollment requirement. Of course, if State licensing rules require any of these types of facilities to be licensed, the facilities would have to be licensed in order to be eligible to participate in CACFP.

The Department received 156 comments on the enrollment form requirements promulgated in the second interim rule, from 141 institutions, seven advocacy groups, four State agencies, and four providers. Eight commenters fully approved of the changes to enrollment requirements, and 17 opposed them, either partially or in their entirety. Among other commenters, 88 asked for flexibility in permitting sponsors to "stagger" the due dates of enrollment forms throughout the year. As noted above, this flexibility was addressed in guidance issued on December 23, 2004, and in the training the Department conducted on the interim rule in 2005.

In addition, 43 commenters suggested that the Department permit enrollments to be updated every 14 months, to avoid the possibility that providers or centers would lose reimbursement for families that were late in turning in their enrollment forms. The Department recognizes that, for any number of reasons, enrollment forms may not be

updated exactly on a 12-month cycle.

This was addressed in guidance (questions and answers) issued on February 23, 2006, which permitted State agencies to allow a "rule of reason" about the enrollment deadline. Although that guidance did not specify a maximum period of time that could elapse between enrollments, it did provide the example of an enrollment form first collected on September 7, 2005, which could be considered valid through the end of September 2006. The Department expects State agencies and "sponsoring organizations" to use this flexibility responsibly, consistent with the regulatory requirement at §§ 226.15(e)(2) and (e)(3), 226.17(b)(7), and 226.18(e) to collect enrollment forms "annually."

#### *E. Required State Agency and Sponsor Review Elements*

The second interim rule established specific requirements for the content of sponsoring organization reviews of facilities and State agency reviews of institutions. Prior to this, the CACFP regulations had simply mandated the timing and number of facility and institution reviews to be conducted, not their content.

The changes were initially presented in a proposed rule issued on September 12, 2000, and implemented in the second interim rule. These proposed changes elicited widespread support, and were adjusted only slightly in the second interim rule, based on comments submitted in response to the Department's proposed rule of September 12, 2000. Comments were received on two aspects of the interim rule's State and sponsor review elements: The requirement that both State agencies and sponsoring organizations conduct a "five-day reconciliation" as a part of each facility review they conducted; and, the requirements pertaining to the State agency's conduct of unannounced reviews of a meal service.

The second interim rule required that every State agency review of a sponsor (which also includes reviews of a representative sample of the sponsor's facilities), and every sponsor review of facilities must include a "five-day reconciliation." Five-day reconciliation requirements were included as a sponsor review element in the second interim rule as a means for a sponsor to "spot check" the accuracy of facility claims. They were required to be included in State agency reviews of sponsors' facilities in order to again check the accuracy of the facility's meal counts, and to "spot check" the

effectiveness of the sponsor reviewers' conduct of five-day reconciliations.

The theory and practice of five-day reconciliations is simple. Reviewers must check enrollment, attendance and meal counts in the facility for a five-day period to see if they match, or "reconcile." If they do, it is more likely that the facility is keeping accurate enrollment and attendance records and is accurately reporting the number of meals served each day. If they do not, the reviewer must attempt to determine the reason(s) for the discrepancies, and decide whether an overclaim should be established.

Nine comments were received on the five-day reconciliation requirement implemented in the second interim rule: Four from institutions; four from State agencies, and one from an advocacy group. One State agency commenter suggested that meal counts be reconciled to enrollment only, while the other eight commenters suggested that meal counts be reconciled to attendance alone. The regulations at §§ 226.15(e)(2), (3), and (4), and at § 226.18(e) require that all participating facilities have both types of records, except in those types of facilities in which enrollment forms are not required (outside-school-hours care centers, at-risk afterschool programs, and emergency shelters). Thus, the Department believes that comparing both enrollment and attendance records to five days of facility meal counts will ensure that the meal claimed was served to a child who was enrolled for care and who was in attendance at the time of the meal service.

In order to minimize the possibility of future misunderstanding of these requirements, the Department will make one minor change in this final rule to the language governing five-day reconciliations at §§ 226.6(m)(4) and 226.16(d)(4)(ii). As currently written, § 226.6(m)(4) states that State agency facility reviews must compare "available" enrollment and attendance records to five days of meal counts. The current language at § 226.16(d)(4)(ii) states that sponsor reviews must compare five days of facility meal counts to "enrollment and/or attendance" records. In both cases, the wording was meant to recognize the previously-mentioned exception to formal enrollment requirements for outside-school-hours care centers, at-risk afterschool programs, and emergency shelters. However, the Department is concerned that this language might be misconstrued to provide sponsors with the option to use either enrollment or attendance records, rather than both, even in facilities where

both types of records are required, and in outside-school-hours care centers, where the free and reduced price application form is often used as a type of "enrollment" form and can be compared to attendance records.

Finally, the Department will make one technical correction to the second interim rule's regulatory language governing the five-day reconciliation. In instructing sponsors on how to conduct a five-day reconciliation in a sponsored facility, § 226.16(d)(4)(ii) states in part that "For each day examined, reviewers must use enrollment and/or attendance records to determine the number of children in care \* \* \*," and later refers to "children in care." Although the five-day reconciliation is a required part of all facility reviews conducted by all sponsors, the use of the words "children in care" could be misread to limit this provision to child care centers only, when in fact it applies to adult day care centers as well. This final rule will amend § 226.16(d)(4)(ii) to substitute the word "participants" for the word "children" both times it occurs.

Accordingly, this final rule amends §§ 226.6(m)(4) and 226.16(d)(4)(ii) to further clarify that five-day reconciliations must include a comparison of meal counts to both attendance and enrollment records, except in those facilities (outside-school-hours care centers, at-risk afterschool programs, and emergency shelters) in which enrollments are not required by the CACFP regulations. It also substitutes the word "participant" for the word "children" both times it occurs at § 226.16(d)(4)(ii).

The second aspect of these requirements about which we received comment involved State agency observations of meal services during reviews. The second interim rule at § 226.6(m)(3)(vii) required that each State agency review of an independent center include an observation of the center's meal service. By contrast, the second interim rule did not require that each State agency review of a sponsored facility (*i.e.*, a review conducted of a sponsored center or a family day care as part of the State agency's review of a sponsoring organization) include the observation of a meal service. Three commenters (two State agencies and one advocacy organization) suggested an expansion of the required State agency review elements, to require that each State agency review of a sponsored facility include an observation of a meal service.

The apparent logic behind this suggestion is sound: The Department requires State agencies to conduct five-day reconciliations when reviewing

sponsored facilities, in part as a means of checking on the adequacy of the sponsoring organization's conduct of five-day reconciliations. The State agency's observation of a meal service would be a means of checking the adequacy of the sponsor monitors' review of the facilities' meal service.

Ideally, the Department would like each State agency review of a facility to cover every aspect of the facility review conducted by the sponsor, including the observation of a meal service. However, the Department was reluctant to add too many requirements to the content of State reviews of facility. The State agency's primary responsibility, in reviewing a sponsor, is determining the adequacy of the sponsor's policies, procedures, and internal controls to ensure effective operation of the program and compliance with program requirements by both the sponsors and its facilities. We strongly encourage State agencies to observe a meal service whenever possible when conducting facility reviews. However, in this final rule, we will not require that a meal service observation always take place, as we do for State agency reviews of independent centers, where no other entity reviews the center's meal service for program compliance.

Finally, the Department will make one technical correction pertaining to sponsor review elements in this final rule. The second interim rule clarified at § 226.15(e)(4) that meal counts may be recorded at the end of the day in family day care homes, as opposed to centers, which are required to record the meal count at the "time of service." However, § 226.11(c)(1) still implies incorrectly that all meals must be recorded at the time of the meal service.

Accordingly, this final rule amends § 226.11(c)(1) to clarify that reimbursements to day care home providers are calculated based on daily meal counts, as opposed to time of service meal counts.

#### *F. State Agency and Sponsor Edit Checks, Including Block Claim Edit Check*

The second interim rule amended the CACFP regulations to require that both State agencies and sponsoring organizations establish monthly edit checks to improve the accuracy of claims payments to institutions and facilities, respectively. Prior to this time, the regulations did not require either State agencies or sponsoring organizations to have particular monthly edit checks built into their payment systems. Nevertheless, most State agencies and sponsoring organizations already had some monthly

edit checks in place in their payment systems, and OIG's suggestion to add two specific edit checks to the CACFP regulations generated little controversy after being proposed in September of 2000.

The one edit check that did generate opposition was that requiring sponsoring organizations to identify "block claims," defined in the second interim rule as any claim submitted by a facility on which the number of meals claimed, for one or more meal type, is identical for 15 consecutive days within a claiming period (generally one calendar month). In addition, the rule required that, once a facility submitted a block claim, a sponsoring organization must conduct an unannounced review of that facility within the next 60 days. In order to provide adequate time for sponsoring organizations to modify their edit checks and review protocols, the Department delayed implementation for 13 months, until October 1, 2005.

In most cases, the Department concluded that this requirement would result in sponsors conducting an additional (fourth) review of a facility during a review year. If the monitor could document a compelling reason for the block claim, no further "60-day follow-up reviews" would be required for the remainder of the review year. In addition, since sponsors were already required to conduct three reviews per year, at least two of which were unannounced, the Department anticipated that the largest impact of this provision—and one that was entirely desirable, from the Department's standpoint—was that sponsoring organizations would need to regularly re-adjust their review schedules, offsetting some sponsors' tendency to conduct reviews of the same facility on approximately the same schedule every year. The Department received 397 comments about the definition of a block claim added to § 226.2 by the second interim rule, and 443 additional comments concerning the requirement that sponsors conduct an unannounced follow-up review within 60 days of a block claim's submission.

Of the 397 comments received concerning the definition of a block claim, 361 were submitted by sponsoring organizations, 14 by providers, and 11 each by State agencies and advocacy groups. All 397 commenters suggested some type of change(s) to the regulatory definition, with most suggesting that the period of the block claim either be revised from 15 days to one full month of claiming the same number of one or more meal types, or that a block claim be defined

as the submission of identical meal counts for all meal services (instead of one or more meal services) over a 15-day period.

Of the 443 comments received concerning the unannounced follow-up review requirement, 417 were from institutions, 18 from advocacy groups, 6 from providers, and 2 from others with no clear affiliation. Four ideas for changing the provision were made in these comments:

- 149 commenters suggested that the time allowed for the conduct of an unannounced followup review should be extended to 90 days following the block claim's submission;
- 94 commenters suggested that, after block claims were identified, sponsors should be required to review a sample of 10 percent of the facilities identified as having submitted such claims (as opposed to reviewing all facilities submitting block claims within 60 days);
- 42 commenters suggested that block claims identified by a monitor during a facility review could be verified during a review, as opposed to requiring a separate follow-up visit (which the Department permitted in guidance issued on July 1, 2005 and May 23, 2006, and made permanent on August 27, 2007); and
- 136 suggested the permanent implementation of a temporary policy permitted by the Department in guidance issued on July 1, 2005 and May 23, 2006, which stated that block claims verified during the last two months of the current review year would eliminate the need to conduct any unannounced followup reviews in the next review year (the Department made this change permanent on August 27, 2007).

Based on the CCAP results, the Department remains very concerned about meal claim integrity in the CACFP. However, based on feedback we have received in comments on the second interim rule and through feedback in other forums, we are now convinced that this particular approach to improving claim integrity has been ineffective. It appears that, when questioning providers about the submission of a block claim after the fact, sponsor monitors do not have enough information to confirm or refute the providers' explanations of the reasons for their block claims. Therefore, this final rule eliminates all reference to block claims and unannounced follow-up reviews at §§ 226.2 and 226.10(c)(3). The Department will continue to explore more effective means of monitoring erroneous meal claims, especially in the

family day care home portion of the CACFP. Readers of this preamble should note that this change is consistent with section 331(b) of Public Law 111–296, the Healthy, Hunger-Free Kids Act of 2010, which was enacted on December 13, 2010.

Accordingly, this final rule removes the definition of “block claim” at § 226.2 of the CACFP regulations and all of § 226.10(c)(3), which described the block claim edit check and the 60-day follow-up review requirement. However, readers should note that, given the evidence in CCAP that a substantial minority of providers continue to be out of compliance with recordkeeping and daily meal counting requirements, the Department will continue to try to develop an efficient and effective means of identifying improper payments by family day care homes and sponsored centers. Ultimately, the Department is required by the Improper Payments Information Act of 2002 to establish a means of measuring facility error in CACFP. If our efforts indicate the need for sponsors to take other actions to minimize improper facility claims, the Department will issue a proposed rulemaking at that time.

#### *G. Household Contacts*

Based on the results of the Kiddie Care report, the Department proposed in 2000 to require that sponsors make “household contacts” if they detected block claims submitted by their providers. Commenters on the proposed rule were strongly opposed to this, and in the second interim rule published in 2004, requirements pertaining to both block claims and household contacts were quite different than what had been proposed in 2000. Commenters' responses to the block claim edit check requirements promulgated in the second interim rule were discussed in Part II(F) of this preamble. This part of the preamble addresses commenters' responses to the new household contact requirements established in the second interim rule.

After having attempted, in the proposed rule published in 2000, to provide detailed guidance on when and how household contacts should be made, the Department adopted a very different approach in the second interim rule. We still believed that the OIG report had presented a compelling case for the use of household contacts as an oversight tool—whether by sponsoring organizations, State agencies, or both—as a means of confirming children's attendance at and enrollment for child care, which is critical to ensuring the integrity of facility meal counts in

CACFP. However, we adopted commenters' suggestion that the Department should not attempt to describe and require all of the elements of a household contact system. Instead, the second interim rule required State agencies to develop (by April 1, 2005) a system which defined the circumstances under which the State agency and sponsoring organizations would be required to make household contacts. State agencies were also required to review and evaluate sponsors' implementation of the State agency's system during every review of the sponsor.

The Department received 213 comments on this aspect of the second interim rule. Ninety-eight (98) commenters (93 institutions, 4 advocacy groups, and one State agency) stated that sponsors should have the flexibility to define their own household contact systems, rather than having the State agency develop a household contact system for all sponsors in the State. The Department made a deliberate choice to provide this authority to State agencies, rather than sponsors. Although we expected and wanted State agencies to consult with sponsors in developing these systems, the Department believed it would be inappropriate to permit sponsoring organizations to define the way this oversight tool would be used, since it would have a direct impact on their workload and, if not properly established and implemented, would not yield meaningful results.

In addition, 15 provider commenters expressed concern that vindictive parents could abuse a household contact system, by deliberately providing false information to the sponsor or State representative making the contact. While we acknowledge that this is a possibility, the Department believes that it is a remote possibility. Parents who are dissatisfied with their child's day care home provider tend to change providers, making it less likely that a “vindictive” parent would deliberately provide false information. Meanwhile, in our training on this provision, we emphasized that sponsors should consider multiple sources of information when attempting to discern whether their providers were submitting accurate meal counts. A household contact is one way—but certainly not the only way—of establishing the accuracy and integrity of provider meal counts.

Finally, 98 commenters (93 institutions, 4 advocacy groups, and one State agency) stated that State agencies' household contact systems should never link the submission of block claims to the requirement to conduct a household

contact. The Department notes that, although this final rule removes all Federal requirements pertaining to block claims, it does not affect a State agency's ability to link household contact requirements to block claims. Each State agency will have its own approach to defining the circumstances under which sponsors must conduct household contacts, and the Department will not attempt to limit State agencies' options in this regard. We expect that, in establishing and modifying household contact systems, a State agency will devise a system that it believes is best suited to the particular management challenges to proper implementation of CACFP in their State.

#### *H. Sponsoring Organization Review Cycle*

The second interim rule implemented several changes to the cycle for sponsoring organizations' conduct of facility reviews. Several small differences that previously existed between the review cycle for different types of facilities were eliminated in the interim rule, which now requires sponsors to review each facility (regardless of whether it is a home or any type of center) three times a year, with two of these visits being unannounced and at least one unannounced review being conducted of the facility's meal service. Having uniform review requirements for all types of facilities had been positively received by commenters on the original proposed rule issued in 2000, and no further comments on this aspect of the review cycle changes were received. The only aspect of the review cycle about which comments were received was the change made to the provisions governing sponsors' use of "review averaging."

Prior to the second interim rule, sponsoring organizations could "average" their facility reviews only with the approval of the State agency. "Review averaging" simply means that a sponsoring organization with 100 facilities, must still conduct 300 reviews, but does not have to review each of its 100 facilities three times each. This flexibility has always been intended to permit sponsoring organizations to devote more time reviewing facilities that are new, or that have a history of problems with program compliance.

Given the two interim rules' emphasis on targeting problem institutions and facilities for more oversight, and given the number of new oversight requirements that sponsors would have to perform, the Department decided that sponsoring organizations should have

the flexibility to decide (without prior State agency approval) whether or not to use review averaging as a management tool. In this way, sponsors would be able to review high-performing facilities less frequently and error-prone facilities more frequently.

The second interim rule placed several limits on sponsors' use of review averaging. First, for those facilities not being reviewed three times in a review year, the Department required that sponsors still conduct two unannounced reviews. Second, no facility could be reviewed only two times in a review year if it was determined seriously deficient in one of the reviews, or if it submitted a block claim at any time during the review year. Finally, regardless of the sponsor's use of review averaging, individual facility reviews would have to occur no more than nine months apart from one another.

The Department received 208 comments on its implementation of review averaging, including 195 from institutions, five from advocacy groups, one from a State agency, and seven from commenters whose affiliation could not be determined. These commenters asked for slightly more flexibility for sponsors in utilizing this provision. Specifically, they requested that the concept of "averaging" be extended from the total number of reviews to the averaging of unannounced reviews as well. In other words, the sponsor of 100 facilities would still have to conduct 300 reviews, 200 of which would be unannounced, but could distribute the unannounced reviews in any manner it saw fit.

The Department largely agrees with this proposal, but does want to ensure that each facility receives at least one unannounced review each year. This will give sponsors more flexibility than they currently have in targeting review resources to error-prone facilities, but will continue to ensure that each sponsored center or family day care home receives one or more unannounced reviews each year.

Accordingly, the Department will make the appropriate changes to § 226.16(d)(4)(iv), including the elimination of the last sentence, which previously limited the provision's applicability when a facility had submitted a block claim. Because the block claim requirements have been removed in this final rule, the last sentence of § 226.16(d)(4)(iv) is no longer relevant, and will be removed.

#### *I. Requirements Pertaining to Family Day Care Home Providers Who Qualify for Tier I Reimbursements on the Basis of Their Receipt of Benefits Under the Supplemental Nutrition Assistance Program (SNAP)*

The second interim rule included new requirements for oversight of a family day care home provider who established eligibility for tier I meal reimbursements on the basis of the provider's household's participation in the Supplemental Nutrition Assistance Program (SNAP), formerly known as the Food Stamp Program. Our attention was called to this issue by the OIG's Kiddie Care report, which found that some of these providers were not revealing, or were understating, the amount of income they received as child care providers when applying for SNAP benefits. In so doing, the provider either received a larger SNAP allotment than she was entitled to receive, or was incorrectly determined eligible for SNAP. In some cases, a full accounting of household income would also have made the day care home provider ineligible to receive CACFP reimbursement for meals served to her own child(ren).

To deal with this problem, the second interim rule required that sponsoring organizations provide to the CACFP State agency a list of day care home providers who qualified for tier I eligibility on the basis of the household's SNAP participation. The CACFP State agency, in turn, was required within 30 days to provide this information to the agency of State government responsible for administering SNAP. After receipt of the information, the SNAP State agency was required, consistent with 7 CFR Part 273.12(c), to consider this information in determining the household's SNAP eligibility.

The Department received 138 comments on these provisions of the second interim rule. Of these, 92 commenters (88 institutions and 4 advocacy groups) recommended that the Department monitor the impact of this provision to ensure that providers on the list were not "unfairly targeted" for investigation by State or local SNAP offices. Forty-six (46) other commenters (including 43 institutions, one State agency, and two advocacy groups) stated that the onus for gathering this information should be on State and local SNAP offices and not on the sponsors and State agencies responsible for administering the CACFP.

As an agency, the FNS is responsible for administering both SNAP and the CACFP. While we encourage

participation by eligible individuals in both programs, we must also ensure that those receiving the programs' benefits meet the statutory requirements for eligibility. Specifically, we must ensure that providers accurately report their household income, including the income they receive for providing child care, in order to determine that accurate benefits are being provided under both CACFP and SNAP. The OIG report raised concerns about providers' self-employment income which FNS could not ignore, and we addressed these concerns in a way that would provide the information necessary to the State agencies responsible for administering these programs under agreements entered into with FNS. As stated in our implementation guidance of March 29, 2005, the inclusion of a provider on this list does not demonstrate noncompliant activity, and State or local SNAP offices receiving the list would not use it to "target" individuals for inappropriate review.

### Part III. Training and Other Operational Requirements

#### Introduction

Sections 243(c), (d), (e), and (f) of ARPA added statutory provisions which affected various aspects of State agencies and sponsoring organizations' operation of the Program. These changes were designed to improve Program management and integrity by establishing requirements concerning:

- Center sponsors' use of administrative funds;
- Family day care homes' ability to transfer from one sponsor to another;
- State agencies' recovery of funds disbursed to institutions; and
- Serious deficiency, termination, and appeals procedures for family day care homes participating in the Program.

The changes made to these aspects of Program operations were discussed in Part III of the interim rule published on June 27, 2002, which implemented all of the changes mandated by ARPA in the CACFP regulations. Comments were received on three of these changes, and are discussed below.

As part of the discussion of the serious deficiency process for family day care homes, this section of the preamble will also include a discussion of the requirement that sponsors collect each provider's date of birth on the provider's Program application, and that the sponsor report the provider's date of birth to the Department whenever a provider is added to the NDL. As in Parts I and II of this preamble, a number of the issues raised by commenters have already been addressed in guidance or

training, and do not require extensive discussion in this preamble.

#### A. Ceiling on Administrative Reimbursements for Sponsors of Centers

Section 243(e) of ARPA established a fifteen (15) percent limit on the amount of meal reimbursement that sponsors of centers could retain to cover their administrative costs. This statutory limit grew out of OIG audit and State review findings that showed some sponsors of centers retaining 50 percent or more of the meal reimbursement for administrative costs. Because administrative costs for monitoring may be higher when a center sponsor administers CACFP in widely dispersed rural centers (especially if many of the children served in those centers do not qualify for free or reduced price meals), the law permitted a center sponsor to apply to the State agency for a waiver of the 15 percent "ceiling," if warranted.

The Department received 152 comments on these provisions from 7 State agencies, 119 institutions, 19 advocates, and 7 commenters whose institutional affiliation could not be identified. Many of these commenters (106) believed that the ceiling on administrative costs would significantly increase administrative burden for center sponsors, and that administrative reimbursement rates should be adjusted accordingly. However, as there is no separate administrative reimbursement rate for sponsors of centers, it appears that these commenters may have been suggesting that the "ceiling" on the amount that sponsors of centers could retain for their administrative costs should be increased above 15 percent. Because the ceiling is set by law, the Department is not in a position to modify it. Furthermore, the Department believes that the 15 percent ceiling—which is roughly comparable to the separate administrative rate received by sponsors of family day care homes—is adequate to cover center sponsors' administrative expenses, especially since sponsors have the ability to request a waiver when unusual circumstances might cause them to exceed the 15 percent ceiling.

Forty (40) other commenters stated that, in order to implement this provision more easily, center sponsors should simply receive 15 percent of their centers' total meal reimbursement. However, the Department reminds commenters that the law stated that center sponsors should be allowed to retain "up to 15 percent" of the meal reimbursement earned by their centers. This wording makes clear that Congress expected a sponsor with documented, Program-related administrative costs

that totaled only 10 percent of its centers' meal reimbursements would receive that amount (10 percent), and not more. Even if the statute had not included the words "up to," a system under which center sponsors simply received 15 percent of the meal reimbursements earned by their sponsored centers each month would potentially expose these sponsors to large overclaims. If the State agency later reviewed the sponsors' financial records and found inadequate documentation to support the reasonableness, necessity, and allowability of all administrative costs being charged to the program, the State agency would be required to establish an overclaim against the sponsor.

Finally, six State agencies submitted other comments related to these provisions. Three State agencies stated that the provision should apply only to sponsors of "unaffiliated" centers (*i.e.*, centers that are not owned by the sponsoring organization). As this idea has been explained to us in meetings, these State agencies believe that a for-profit sponsor that owns sponsored centers can "do what it pleases" with regard to the funding that is targeted to the sponsored centers. While this may be true for other aspects of a for-profit sponsor's operation of the centers it owns, it is the Department's intent that all CACFP sponsors—regardless of whether they are nonprofit or for-profit in nature—operate the program principally for the benefit of children. The law makes no distinction between affiliated and unaffiliated centers, and therefore requires us to apply the 15 percent ceiling to all center sponsors.

One State agency recommended that the waiver option be removed, or that State agencies' decisions regarding a waiver not be subject to administrative appeal. The Department notes that section 17(f)(2)(C)(ii) of the NSLA establishes these waivers, and the Department may not remove the waiver provision without a change to the law. Furthermore, section 17(e) of the law requires that institutions be provided with the opportunity for an administrative hearing whenever an action taken by the State agency affects the institution's claim for reimbursement.

One State agency recommended that a higher rate be established for sponsors of centers located in rural areas. Again, there is no administrative "rate," *per se*, for sponsors of centers. The law establishes a "ceiling" on the amount of the sponsored centers' meal reimbursement that the sponsor may retain for its Program-related administrative expenses. In describing

the waiver provision in the preamble to the first interim rule, the Department specifically discussed the possible need for waivers when sponsors operated CACFP in rural areas, especially when its rural centers were geographically dispersed and/or served large numbers of children whose meals were not eligible for free or reduced price reimbursement.

Finally, one State agency recommended that the 15 percent ceiling apply only to sponsors of centers, and not to the individual centers being sponsored. As explained in the preamble to the first interim rule, the Department anticipates that centers choosing to be sponsored (as opposed to independent centers, which take responsibility for all aspects of Program operation and sign an agreement to do so with the State agency) do so only when they feel they are not capable of taking on the administrative challenges of CACFP and, therefore, anticipate that their sponsor will handle all Program-related administrative tasks. The Department believes that requiring the sponsor to account separately for administrative tasks performed by sponsored centers is necessary to discourage center sponsors that might be tempted to pass some Program-related administrative responsibilities to their sponsored centers, but still retain 15 percent of the centers' meal reimbursement.

#### *B. Procedures for Recovering Funds Disbursed to Institutions*

Section 243(d) of ARPA added provisions to the NSLA affecting the recovery of funds already disbursed to institutions. The statute amended section 17(f)(1)(B) of the NSLA to permit State agencies to establish "payment schedules" that allowed institutions to repay claims over a period of one or more years; clarified that institutions may not repay Program claims out of funds intended for meal reimbursement; and underscored that institutions must be provided the opportunity to appeal when claims were established. Despite permitting payment schedules, the law did not waive normal debt collection procedures, and the Department added language in the first interim rule to clarify that, when claims were not repaid promptly, interest would accrue on the outstanding debt until it was paid in full.

The Department received eight State agency comments on its implementation of these provisions in the first interim rule. All of these comments concerned the inclusion of regulatory language regarding the collection of interest from institutions owing a debt to the

government. Commenters stated that the collection of interest in CACFP imposed a special burden unlike other child nutrition programs. They also requested instructions on how to calculate interest owed and suggested that interest be calculated as of 30 days from the due date, not from the date of the claim notice.

Calculation of interest follows the annually-update "current value of funds rate," which is available at <http://www.fms.treas.gov/cvfr/index.html>. However, the Department does believe that it erred in promulgating regulatory language stating that "the State agency must assess interest beginning with the initial demand for remittance." This language will be amended in this final rule, to require the collection of interest if the debt is not paid by the date stipulated in the State agency's demand letter, or 30 days after the date of the demand letter, whichever date is later.

Accordingly, § 226.14(a) is amended to include the change to the language regarding the assessment of interest as described immediately above.

#### *C. The Serious Deficiency Process for Family Day Care Homes (FDCH)*

As mentioned above, ARPA added to the NSLA a requirement that the Department establish a serious deficiency process for FDCH providers. Prior to this, some State agencies had established their own serious deficiency processes for providers, and had compiled lists of providers whose Program participation had been terminated for cause. Section 243(c) of ARPA amended section 17(d)(5) of the NSLA to require that the Department establish a nationwide serious deficiency process for providers and that, if disqualified from CACFP, these providers would be placed on the NDL, just like institutions that failed to correct their serious deficiencies.

The Department received 595 comments on its implementation of ARPA's provision establishing a serious deficiency process for providers. The vast majority of these comments (487) were submitted by institutions. Other comments came from advocacy groups (55), State agencies (2), providers (2), and persons for whom an institutional affiliation could not be determined (49).

Of these, 40 commenters stated that they were pleased with the change to the statute and the way that FNS implemented the law's provisions in the first interim rule. Another 278 commenters (236 institutions, 22 advocates, one provider, and 19 "others") believed that the regulatory language used in the interim rule was not specific enough. Most of these (273

of 278) believed that the regulatory language should be changed to require that a sponsor declare a provider seriously deficient only when the provider, in the words of ARPA, "substantially fails to fulfill the terms of its agreement." These commenters believed that, as written, the second interim rule would force sponsors to declare providers seriously deficient whenever an error was made, regardless of the frequency or severity of the error.

Since that time, the Department has provided extensive training to State agencies on implementing the first interim rule and State agencies, in turn, have provided extensive training to sponsoring organizations. Throughout its training on the serious deficiency process for providers, the Department has emphasized that, in determining whether a declaration of serious deficiency is warranted, sponsoring organizations should assess the frequency and severity of the errors committed by providers. In the years since the first interim rule was published, the Department has encountered few, if any, instances of sponsoring organizations interpreting the regulations too narrowly, and declaring providers seriously deficient for minor clerical errors. In fact, the CCAP report more strongly suggests that too many sponsors may be slow to require providers to implement meaningful corrective action when serious problems with meal counting occur, and overly-reluctant to employ the serious deficiency process.

In addition, the Department received 275 comments concerning the amount of time given providers to resolve serious deficiencies. All but one of these commenters stated that providers should be given more than 30 days to correct a serious deficiency. In the first interim rule, institutions were given varying lengths of time to resolve such issues, depending on the nature of the serious deficiency. Providers, on the other hand, always have a maximum of 30 days to fully correct any serious deficiency. The Department understands that this disparity may appear to be detrimental or unfair to providers. However, giving institutions and providers different periods of time to correct a serious deficiency is necessary because of the nature of sponsors' monitoring of providers and the financial incentives that sponsors have to retain providers in the Program.

Sponsors conduct three reviews of each provider each year, two of which are unannounced. Unless the monitor finds an egregious problem involving intentional over-claiming of meals or serious non-compliance with the



Program meal pattern, the sponsor usually does not declare the provider seriously deficient when the problem is first discovered. More typically, the monitor requires that the provider take corrective action without finding the provider seriously deficient, then returns for the next review three to four months later to determine whether the provider has fully implemented the corrective action. Unfortunately, even if a monitor continues to find serious problems with the provider's operation of the Program, some sponsors are still very reluctant to issue a declaration of serious deficiency unless there is clear proof that the provider has falsified its meal claims. By the time a serious deficiency is declared, almost all providers will have already had one or more chances (in other words, given the interval between the monitor's reviews of that provider, three to nine months) to implement effective corrective action. Once a sponsor reaches the point of issuing a notice of serious deficiency to a provider, then it is imperative that the sponsor require the provider to quickly correct the deficiency, knowing that if the provider does not, the sponsor will propose to terminate Program participation in 30 days or less.

Two State agency commenters also made suggestions for changes to the first interim rule. One suggested that the State agency option to hear provider appeals be removed; the other suggested that sponsors of centers should also be required to establish a serious deficiency process for their sponsored centers. After consideration, we concluded that it is unnecessary to remove an option that a small number of State agencies have chosen to exercise. If the State agency in question wishes to decline hearing provider appeals, it may do so. It should assist sponsors in establishing a sponsor-level appeals process, and then turn the process over to sponsors once it is in place.

With regard to a serious deficiency process for centers, the Department has taken every opportunity to recommend that State agencies or center sponsors establish a serious deficiency and appeals process for sponsored centers. Section 17(d)(5) of the NSLA requires the process to be established for institutions (and by extension, those responsible principals and individuals from institutions that are proposed for disqualification) and for family day care home providers, but does not mention sponsored centers. Therefore, the requirement for such a process for sponsored centers was not included in the first interim rule. Nevertheless, we believe that establishing such a process

for sponsored centers is an excellent management practice. We again urge State agencies or sponsors to establish a serious deficiency process for sponsored centers, and we will consider proposing such a change, and soliciting public comment, in future rulemakings.

Finally, the Department received 264 comments concerning the first interim rule's requirement at 226.18(b) that a provider must submit her date of birth as part of the sponsor's agreement with the provider. **[Please note that the first interim rule also required that the executive director and the chairperson of the institution's board of directors must submit their dates of birth on the institution's application. Several of the comments discussed below pertain to that requirement, as opposed to the provider date of birth requirement.]** Most of these comments (223) requested more time to implement this requirement, which now has been fully implemented. Among the other 41 comments, 25 (6 State agencies, 9 institutions, 7 providers, and 3 advocates) stated that the date of birth requirement should be eliminated because it was not verifiable and because it is an "invasion of privacy." Three other State agencies believed that the provision of a date of birth made providers on the National Disqualified List (NDL) more likely to be the victims of identity theft.

In order to ensure that those using the NDL could differentiate between multiple individuals with the same name, the Department needed to include a unique identifier for each name on the list. This was especially important after the law expanded the number of names that could be placed on the list by including FDCH providers. Although the Department is permitted by law to collect Social Security Numbers on household applications for child nutrition benefits, ARPA law did not provide such authority as part of requiring that providers be placed on the NDL. Therefore, the Department needed to obtain an identifier that would differentiate between persons with the same name who appear on the NDL. The Department is very sensitive to Program participants' concerns regarding identity theft, and has allowed access to the NDL only to those Program personnel who must determine institution or provider eligibility. Therefore, we are convinced that the provider's date of birth is the best identifier available for this purpose.

Six other State agency staff suggested that collection of the date of birth be optional; that State agencies should be allowed to make exceptions to these requirements for good cause; or that it

be required only after a provider or institution is determined seriously deficient. Because, as explained above, the Department determined that this is the best identifier available for this purpose, none of these changes will be made.

The Department received two comments from State agencies on the collection of a date of birth from an institution's executive director or board chair. One commenter suggested that the date of birth should be collected from all "responsible staff" at the time of the institution's application; the other suggested that the owners of for-profit independent centers (who are neither the "executive director" nor the "board chair" of their organization) should also be required to submit their date of birth.

With regard to the first comment, the Department will not expand the date of birth requirement beyond the executive director and board chair in this final rule. We do wish to point out, however, that consistent with § 226.25(b), any State agency wishing to require that more dates of birth for additional personnel be collected on an institution's application may establish that requirement. With regard to the second comment, the Department will clarify in this final rule that the regulation at §§ 226.6(b)(1)(xv) and 226.6(b)(2)(v) should be construed to require that State agencies collect dates of birth from owners of for-profit independent centers at the time of the center's application.

Accordingly, this final rule amends §§ 226.6(b)(1)(xv) and 226.6(b)(2)(v) to clarify that for-profit owners, and other individuals with overall responsibility for an institution's management of the CACFP, regardless of title, must submit a date of birth on the institution's Program application.

Finally, to clarify the word "rescind," as was done in Part I(B) of the preamble, the Department will remove the word "rescind" at § 226.16(l)(3)(ii) and replace it with the words "temporarily defer." In addition, the Department will add a new sentence to § 226.6(l)(3)(ii) to state clearly that, if the sponsor accepts the provider's corrective action, but later determines that the corrective action was not permanent or complete, the sponsor must then move to the next step in the serious deficiency process (*i.e.*, proposed termination and disqualification), without re-starting the serious deficiency process.

Accordingly, this final rule makes the changes to § 226.16(l)(3)(ii) described in the preceding paragraph.

#### D. Technical Corrections

This final rule also corrects five technical errors relating to the regulations dealing with training and other operational requirements, and updates the mailing address for the Agency's Western Regional Office in 7 CFR parts 210, 215, 220, 225, 226, and 245.

First, the second interim rule included language at § 226.16(l)(3)(i)(F) that states that a day care home will be terminated "by the State institution." This should instead read, "by the sponsor." The final rule also clarifies references to the "institution" in §§ 226.16(l)(3)(i)(E) and (F) by substituting the words "sponsoring organization."

Second, the regulations at § 226.15(e)(2) state that, because of the nature of care provided, outside-school-hours care centers, emergency shelters, and at-risk after-school care centers are exempt from the requirement to enroll each child in care, and maintain and update annually documentation of that enrollment. However, the definition of "claiming percentage" at § 226.2 still states that a claiming percentage is calculated based on the number of "enrolled" participants. This final rule amends the definition by adding a second sentence describing how outside-school-hours care centers may calculate a claiming percentage.

Third, when printing the CFR, errors were made in transcribing the amended text of §§ 226.18(a)(1), 226.18(a)(2), 226.18(b)(1), and 226.18(b)(2) as it was submitted in the first interim rule. This final rule corrects the errors, which will result in a corrected text in the CFR.

Fourth, in amending the regulations at § 226.15(e)(14), the second interim rule did not make clear that sponsor monitors are to be trained annually. Even though § 226.16(d)(3) stated that all of a sponsor's "key staff" must be trained annually, we believe that § 226.15(e)(14) should be amended to make clear that monitors are among the "key staff" who must be trained annually.

Fifth, this final rule corrects an error in the first sentence of § 226.23(d) by inserting two words ("public release") inadvertently dropped from that sentence in a previous rule.

Finally, this rule updates the address of the FNS's Western Regional Office in §§ 210.30(e), 215.17(f), 220.21(e), 225.19(g), and 226.26(g).

Accordingly, this final rule makes changes to § 226.16(l)(3)(i)(F); the definition of "claiming percentage" at § 226.2; §§ 226.18(a)(1), 226.18(a)(2), 226.18(b)(1), 226.18(b)(2);

§ 226.15(e)(14); § 226.23(d); and §§ 210.30(e), 215.17(f), 220.21(e), 225.19(g), and 226.26(g), as described immediately above.

#### Part IV. Non-Discretionary Changes Required by PRWORA, the Healthy Meals Act, and the Goodling Act

In addition to the changes discussed in parts I–III of this preamble, the second interim rule also included a number of nondiscretionary changes from statutes other than ARPA. Nondiscretionary changes are those that are specifically mandated by Congress, and, therefore, must be included in the Program regulations. Although nondiscretionary changes may be issued without first soliciting public comment, we included these provisions in the second interim rule both as a matter of convenience and as a means of gathering comments on the manner in which we implemented the provisions.

The Department received public comments on three of the non-discretionary changes included in part IV of the preamble to the second interim rule: the issuance of advances to institutions participating in CACFP; the provision of information on the WIC Program; and the provision of audit funding to State agencies. We received no comment on any other changes made in part IV of the preamble of the second interim rule and, therefore, all of those provisions are adopted without change in this final regulation.

##### A. Issuance of Advances to Institutions Participating in the CACFP

Prior to passage of the Public Law 104–193, the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), State agencies were required to issue advance payments to CACFP institutions that requested them. Section 708(f) of the PRWORA, however, amended section 17(f) of the NSLA (42 U.S.C. 1766(f)) to make the issuance of advances optional. To implement this statutory requirement, the second interim rule amended the Program regulations to make clear that issuance of advances is at the discretion of the State agency. In the preamble to that rule, and in previous guidance issued in 1997, we had clarified that State agencies may elect to issue advances to all institutions, no institutions, specific types of institutions, or institutions with records of adequate Program administration. Only when a State agency denies an advance to an institution based on the institution's Program performance is it necessary to offer an appeal of the State agency's decision.

We received a total of 133 comments on this provision. Of those, 88 sponsors and 2 advocacy groups recommended that we encourage State agencies to continue issuing advances. The comments suggested that denying advance payments would have a negative impact on participation in CACFP. Additionally, 38 sponsors and 4 advocacy groups urged us to request that Congress eliminate the State agency option with regard to administrative advances and, instead, reinstate the requirement that State agencies make administrative advances available to all sponsors upon request. One State agency submitted a comment in support of the proposed changes.

Congress has required that the issuance of advances be at the discretion of the States. We have provided States with guidelines on the appropriate means for providing advances should they decide to do so. It would be inappropriate for us to encourage or discourage advances when Congress clearly left this decision up to the States. Accordingly, the final regulation is unchanged.

##### B. Provision of Information on the WIC Program

Section 107(i) of Public Law 105–336, the William F. Goodling Child Nutrition Reauthorization Act (Goodling Act), required the Department to provide information to State agencies regarding the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) Program. In the interim rule, we amended § 226.6(r) to require that State agencies distribute this information to each participating institution and § 226.15(n) to require that institutions make this information available to parents of enrolled children. (Since the publication of the interim rule, additional revisions have been made to § 226.15, and the provision relating to providing WIC information is now located at § 226.15(o).)

We received six comments on this provision. One sponsor and one advocacy organization recommended that the WIC notification be a one-time requirement when a family enrolls in CACFP. However, the statute requires the State agency to ensure that participating family and group day care homes and child care centers receive periodic updates of WIC information and that the information is provided to parents of enrolled children. Therefore, WIC information must be provided to parents upon enrollment, and additional updates must be provided when there are changes to the way in which households may obtain information

about WIC or when there are changes to the WIC Program's eligibility rules.

Of the remaining comments, one State agency and two sponsors suggested that the WIC State agency bear the cost of the WIC notification materials, rather than the sponsors, and one sponsor suggested that WIC agencies be required to distribute CACFP outreach materials. These requirements were not included in the legislation and may not be imposed through this final rule.

Finally, this regulation makes technical corrections to the WIC provision in the interim rule. In our prior implementation of this statutory requirement, § 226.6(r) requires State agencies to provide WIC information to "participating institutions," which would include all institutions participating in CACFP. Additionally, § 226.15(m) [now § 226.15(o)] required institutions to provide information to the parents of all "enrolled children." However, the statutory language limited this provision to family and group day care homes and child care centers and specifically excluded institutions providing care to school children outside school hours. Therefore, the regulation should have exempted from this requirement those institutions participating in CACFP as outside school hours care centers, at-risk afterschool snack programs, homeless shelters, and adult day care centers.

Accordingly, this final regulation is amended at §§ 226.6(r) and 226.15(o) to clarify that WIC information must only be distributed to the parents of children enrolled in family and group day care homes and in traditional child care centers.

#### C. Audit Funding for State Agencies

Section 107(e) of the Goodling Act amended section 17(i) of the NSLA (42 U.S.C. 1766(i)) by reducing the amount of audit funding available to State agencies. Prior to this change, State agencies received an amount equal to two percent of Program expenditures during the second preceding fiscal year in order to conduct program audits. In 1999, this was reduced to one and one-half percent of Program expenditures and to one percent for fiscal years 2005 to 2007. In the interim rule, we amended § 226.4(h) to include these reductions. (Since the publication of the interim rule, additional revisions have been made to § 226.4, and the provision relating to audit funds is now located at § 226.4(j).)

We received 136 comments on this provision, all of which supported the restoration of State audit funds to the two percent level. Because the Goodling Act called for the reduction, the final

regulation incorporates the reduction to the one and one-half percent level.

However, the reference in the interim rule to the one percent level of funding for fiscal years 2005 to 2007 is no longer necessary as this period has expired and the funding level has returned to one and one-half percent.

Accordingly, § 226.4(j) is amended in the final regulation to remove the reference to the one percent funding level for fiscal years 2005 to 2007.

#### Part V. Procedural Matters

##### *Executive Order 12866 and Executive Order 13563*

Executive Orders 13563 and 12866 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This rule has been designated a "significant regulatory action" although not economically significant, under section 3(f) of Executive Order 12866. Accordingly, the rule has been reviewed by the Office of Management and Budget.

##### *Regulatory Flexibility Act*

This final rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601–612). It has been certified that this rule will not have a significant economic impact on a substantial number of small entities.

The CACFP is administered by State agencies and by over 21,000 institutions (sponsoring organizations and independent centers) in over 194,000 facilities (independent and sponsored centers and family day care homes). The vast majority of institutions and facilities participating in CACFP are "small entities". Nevertheless, the changes implemented in this rule will not have a significant economic impact on most of them. This rule finalizes requirements in the two interim rules that institutions seeking to operate CACFP provide in their applications information related to past performance, financial viability, administrative capability, and internal controls to ensure accountability, and some additional recordkeeping and reporting requirements. These represented marginal increases in the application

burden for almost all of these institutions.

This rule finalizes requirements that primarily affect the procedures used by State agencies in reviewing institutions' applications to participate in CACFP and in monitoring participating institutions' performance. These changes will have a major impact on institutions which are unable to operate CACFP under the new application requirements, or on institutions and facilities which are terminated from CACFP participation as a result of improved monitoring procedures by the State agency or sponsoring organization. However, this occurred for only a small proportion (roughly 2 percent or less) of CACFP institutions and facilities when the requirements were implemented under the interim rules.

In short, there will be little or no adverse impact on those entities administering the CACFP in accordance with Program requirements, since almost all of these changes were implemented in the two previously-issued interim rules in order to improve compliance with existing regulations and in accordance with statutory changes to Program operations.

##### *Regulatory Impact Analysis*

A regulatory impact analysis was completed as part of the development of this final rule. Copies of this analysis may be requested from Ms. Julie Brewer or Ms. Tina Namian at 3101 Park Center Drive, Room 634, Alexandria, VA 22302–1594, or by telephone at (703) 305–2590.

This final rule implements a number of clarifications and changes to existing Program regulations, as implemented in the two interim rules published at 67 FR 43447 (June 27, 2002) and at 69 FR 53501 (September 1, 2004). These changes will affect all entities involved in administering the CACFP. Those most affected will be State agencies, institutions, and facilities.

Despite the conduct of numerous OIG audits, State and FNS reviews, and the Department's own Child Care Assessment Project (CCAP), there is no Nationally-representative information available on the prevalence of meal counting or other errors that impact CACFP integrity. OIG reports have focused on purposely-selected institutions and facilities. Reviews conducted by State agencies and "management evaluations" conducted by FNS are not designed to capture information for the purpose of developing Nationally valid estimates of fraud or mismanagement. The CCAP data collection was limited to family

day care home sponsors operating CACFP in 200 or more homes.

While all of these reports indicate that there are weaknesses in parts of the Program, and that there have been significant weaknesses in oversight by some State agencies and sponsoring organizations, none of these reports can fully estimate the prevalence or magnitude of Program errors. This lack of information makes it difficult for us to estimate with any precision the amount of CACFP reimbursement lost due to fraud, abuse, or mismanagement.

Nevertheless, we are confident that the overall impact of this final rule will be to strengthen program management and integrity in the CACFP:

- By helping to ensure that service providers with inadequate administrative capacity or financial controls or serious management deficiencies are prevented from participating in the program, the rule eliminates important risks of erroneous payments;
- By increasing and improving State oversight of sponsors and providers, the rule helps to ensure that integrity risks are identified and addressed early; and
- By increasing reporting of negative findings by States to USDA, the rule strengthens the Department's ability to identify problem trends and emerging issues and take action.

While the CCAP findings demonstrated that some State and local Program administrators have not fully implemented all of the provisions in the first and second interim rules, they also demonstrated that the rules have helped to eliminate some of the worst types of program fraud uncovered by the Department's Office of Inspector General in the late 1990s. This final rule's further refinement of some of the provisions in those interim rules will continue to improve safeguards against fraud, waste, and abuse, and will result in the more efficient use of Program funds.

#### *Executive Order 12372*

The Child and Adult Care Food Program is listed in the Catalog of Federal Domestic Assistance under No. 10.558. For the reasons set forth in the final rule in 7 CFR Part 3015, subpart V and related Notice published at 48 FR 29114, June 24, 1983, this Program is included in the scope of Executive Order 12372, which requires intergovernmental consultation with State and local officials.

#### *Executive Order 13132*

Executive Order 13132 requires Federal agencies to consider the impact of their regulatory actions on State and

local governments. Where such actions have "federalism implications," agencies are directed to provide a statement for inclusion in the preamble to the regulation describing the agency's considerations in terms of the three categories enumerated in § 6(a)(B) of Executive Order 13132:

#### *Prior Consultation With State Officials*

Prior to drafting this final rule, the Department analyzed more than 1,000 comments submitted in response to the two interim rules. In addition, the Department receives a great deal of ongoing input from State and local agencies.

Since the CACFP is a State administered, Federally funded program, our regional offices regularly have formal and informal discussions with State and local officials regarding Program implementation and performance. This allows State and local agencies to contribute input that may inform our rulemaking, the implementation of statutory provisions, and even our own Departmental legislative proposals. In addition, over the past fourteen years, our headquarters staff has informally consulted with State administering agencies, Program sponsors, and CACFP advocates on ways to improve Program management and integrity in the CACFP. Discussions with State agencies took place in the joint Management Improvement Task Force meetings held between 1995 and 2000; in seven biennial National meetings of State and Federal Program administrators (Seattle in 1996, New Orleans in 1998, Chicago in 2000, New York in 2002, Madison, Wisconsin, in 2004, Orlando in 2006, and Phoenix in 2008); at the December 1999 meeting of the State Child Nutrition Program administrators in New Orleans, and in a variety of other small- and large-group meetings. Discussions with Program advocates and sponsors occurred in the Management Improvement Task Force meetings held in 1999–2000; in annual National meetings of The Sponsors Association, the CACFP Sponsors Forum, and the Western Regional Office-Child Care Food Program Roundtable from 1995 to the present; and in a variety of other small- and large-group meetings.

#### *Nature of Concerns and Need To Issue this Rule*

The issuance of a regulation is necessary to improve Program management and, more specifically, to respond to management problems identified by State and local Program administrators and by OIG. Many of the

interim rule's provisions were discussed in the meetings with State and local cooperators mentioned above. The Department attempted to address in this final rule many of the concerns expressed by commenters on the two interim rules.

#### *Extent to Which We Meet Those Concerns*

FNS has considered the impact of these changes on State and local administering agencies, and has attempted to balance Program integrity concerns with the need to maintain Program access for capable institutions and family day care homes, and to ensure that improvements in accountability do not place undue burdens on State and local Program administrators. The preamble above contains a more detailed discussion of our attempt to balance integrity and access concerns, while implementing these provisions in a manner consistent with both the letter and the intent of the NSLA. Adjustments made by this final rule in response to public comment are discussed at length in the preamble.

#### *Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104–4, requires Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, the Food and Nutrition Service must usually prepare a written statement, including a cost-benefit analysis, for proposed and final rules with "Federal mandates" that may result in new annual expenditures of \$100 million or more by State, local, or tribal governments or the private sector. When such a statement is needed, section 205 of the UMRA requires the Food and Nutrition Service to identify and consider regulatory alternatives and adopt the least costly, more cost-effective, or least burdensome alternative that achieves the objective of the rule.

This rule contains no Federal mandates (as defined in title II of the UMRA) that would lead to new annual expenditures exceeding \$100 million for State, local, or tribal governments or the private sector. Therefore, the rule is not subject to the requirements of sections 202 and 205 of the UMRA.

#### *Executive Order 12988*

This rule has been reviewed under Executive Order 12988, Civil Justice Reform. This rule is intended to have preemptive effect with respect to any State or local laws, regulations, or

policies which conflict with its provisions or which would otherwise impede its full implementation. This rule is not intended to have retroactive effect unless so specified in the **DATES** section of the preamble of the final rule. All available administrative procedures must be exhausted prior to any judicial challenge to the provisions of this rule or the application of its provisions. This includes any administrative procedures provided by State or local governments. In the CACFP, the administrative procedures are set forth at: (1) §§ 226.6(k), 226.6(l), and 226.16(l) which establish administrative review procedures for institutions, individuals, and day care homes; and (2) § 226.22 and 7 CFR parts 3016 and 3019, which address administrative review procedures for disputes involving procurement by State agencies and institutions.

#### *Civil Rights Impact Analysis*

FNS has reviewed this final rule in accordance with Department Regulation 4300-4, "Civil Rights Impact Analysis," to identify any major civil rights impacts this rule might have on children on the basis of age, race, color, national origin, sex, or disability. A careful review of the rule revealed that the rule's intent does not affect the participation of protected individuals in CACFP.

#### *Executive Order 13175*

USDA will undertake, within 6 months after this rule becomes effective, a series of Tribal consultation sessions to gain input by elected Tribal officials or their designees concerning the impact of this rule on Tribal governments, communities and individuals. These sessions will establish a baseline of consultation for future actions, should any be necessary, regarding this rule. Reports from these sessions for consultation will be made part of the USDA annual reporting on Tribal Consultation and Collaboration. USDA will respond in a timely and meaningful manner to all Tribal government requests for consultation concerning this rule and will provide additional venues, such as webinars and teleconferences, to periodically host collaborative conversations with Tribal leaders and their representatives concerning ways to improve this rule in Indian country.

#### *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. Chap. 35, see 5 CFR 1320) requires that OMB approve all collections of information by a Federal agency from the public before they can

be implemented. Respondents are not required to respond to any collection of information unless it displays a current valid OMB control number. This final rule incorporates into the Child and Adult Care Food Program regulations modifications, clarifications, and technical changes to the two interim rules published by the Department on June 27, 2002 and September 1, 2004. Interim rules have the force of law, and the changes in these two interim rules are fully implemented. Thus, information collection requirements for this final rule were included in the renewal of OMB No. 0584-0055 and were approved by OMB on August 3, 2010, with an expiration date of August 31, 2013. During the renewal of OMB No. 0584-0055, information collection requirements were adjusted from the previously reported collection requirements to reflect changes in the number of respondents, time required to respond due to automation and technology enhancements by respondents and removal of obsolete or erroneous burdens listings.

This final rule contains information collection requirements that are subject to review and approval by OMB. FNS will publish a document in the Federal Register once these requirements have been approved. The recordkeeping and reporting burden contained in this final rule have been previously reviewed by OMB, as discussed above. The final rule removes the requirement at 226.10(c)(3) that, "If block claiming is detected, the sponsoring organization must not include that facility among those facilities receiving less than three reviews during the current year, in accordance with § 226.16(d)(4), and must ensure that any facility submitting a block claim receives an unannounced review within 60 days of the discovery of the block claim. If, in the course of conducting this review, the sponsoring organization determines that there is a logical explanation for the facility to regularly submit a block claim, the sponsoring organization must note this in the facility's review file and is not required to conduct an unannounced visit after other block claims detected during the current year." The deletion of this provision results in a reduction of 23,498.40 hours in the reporting and 2,937.30 hours in the recordkeeping burden hours in the currently approved OMB No. 0584-0055, with an expiration date of August 31, 2013. No burden hours were assigned to the State agency since this is primarily a sponsor requirement. FNS is decreasing the burden hours from 7,032,870.18 to 7,006,434.482.

#### Reporting

*Estimated number of respondents:*  
2,200,066.

*Estimated Number of Responses per Respondent:* 2.229056

*Estimated Number of Annual Responses:* 4,904,071

*Estimated hours per response:*  
1.279542

*Estimated Total Annual Response:*  
6,274,963.604

#### Recordkeeping

*Estimated number of respondents:*  
183,120

*Estimated Number of Responses per Respondent:* 3.586

*Estimated Number of Annual Responses:* 656,731

*Estimated hours per response:*  
1.11381

*Estimated Total Annual Response:*  
731,470.878

#### *E-Government Act Compliance*

FNS is committed to compliance with the E-Government Act of 2002, to promote the use of the Internet and other information technologies to provide increased opportunities for citizen access to Government information and services, and for other purposes.

#### **List of Subjects**

##### *7 CFR Part 210*

Children, Commodity School Program, Food assistance programs, Grants programs-social programs, National School Lunch Program, Nutrition, Reporting and recordkeeping requirements, Surplus agricultural commodities.

##### *7 CFR Part 215*

Food assistance programs, Grant programs-education, Grant programs-health, Infants and children, Milk, Reporting and recordkeeping requirements.

##### *7 CFR Part 220*

Grant programs-education, Grant programs-health, Infants and children, Nutrition, Reporting and recordkeeping requirements, School breakfast and lunch programs

##### *7 CFR Part 225*

Food assistance programs, Grant programs—health, Infants and children, Labeling, Reporting and recordkeeping requirements.

##### *7 CFR Part 226*

Accounting, Aged, Day care, Food assistance programs, Grant programs, Grant programs—health, American

Indians, Individuals with disabilities, Infants and children, Intergovernmental relations, Loan programs, Reporting and recordkeeping requirements, Surplus agricultural commodities.

Accordingly, 7 CFR parts 210, 215, 220, 225, and 226 are amended as follows:

#### **PART 210—NATIONAL SCHOOL LUNCH PROGRAM**

■ 1. The authority citation for part 210 continues to read as follows:

**Authority:** 42 U.S.C. 1751–1760, 1779.

##### **§ 210.30 [Amended]**

■ 2. Section 210.30(e) is amended by removing the words “550 Kearny Street, Room 400, San Francisco, California 94108”, and adding in their place the words “90 Seventh Street, Suite 10–100, San Francisco, California 94103–6701”.

#### **PART 215—SPECIAL MILK PROGRAM FOR CHILDREN**

■ 1. The authority citation for part 215 continues to read as follows:

**Authority:** 42 U.S.C. 1772 and 1779.

##### **§ 215.17 [Amended]**

■ 2. Section 215.17(f) is amended by removing the words “550 Kearny Street, Room 400, San Francisco, California 94108”, and adding in their place the words “90 Seventh Street, Suite 10–100, San Francisco, California 94103–6701”.

#### **PART 220—SCHOOL BREAKFAST PROGRAM**

■ 1. The authority citation for part 220 continues to read as follows:

**Authority:** 42 U.S.C. 1773, 1779, unless otherwise noted.

##### **§ 220.21 [Amended]**

■ 2. Section 220.21 (e) is amended by removing the words “550 Kearny Street, Room 400, San Francisco, California 94108”, and adding in their place the words “90 Seventh Street, Suite 10–100, San Francisco, California 94103–6701”.

#### **PART 225—SUMMER FOOD SERVICE PROGRAM**

■ 1. The authority citation for part 225 continues to read as follows:

**Authority:** Secs. 9, 13 and 14, Richard B. Russell National School Lunch Act, as amended (42 U.S.C. 1758, 1761 and 1762a)

##### **§ 225.19 [Amended]**

■ 2. Section 225.19(g) is amended by removing the words “550 Kearney Street, Room 400, San Francisco, California 94108–2518”, and adding in

their place the words “90 Seventh Street, Suite 10–100, San Francisco, California 94103–6701”.

#### **PART 226—CHILD AND ADULT CARE FOOD PROGRAM**

■ 1. The authority citation for part 226 continues to read as follows:

**Authority:** Secs. 9, 11, 14, 16, and 17, National School Lunch Act, as amended (42 U.S.C. 1758, 1759a, 1762a, 1765 and 1766).

■ 2. Section 226.2 is amended by removing the definition of *Block Claim*, amending the definition of *Claiming percentage* by adding a second sentence, and by adding a new definition of *Independent board of directors*.

The revision and addition specified above read as follows:

##### **§ 226.2 Definitions.**

\* \* \* \* \*

*Claiming percentage* \* \* \*. In the case of an outside-school-hours care center that is not required to collect enrollment forms from each participating child, a claiming percentage is the ratio of the number of children in each reimbursement category (free, reduced-price or paid) to the total number of children participating in the program in that center.

\* \* \* \* \*

*Independent governing board of directors* means, in the case of a nonprofit organization, or in the case of a for-profit institution required to have a board of directors, a governing board which meets regularly and has the authority to hire and fire the institution’s executive director.

\* \* \* \* \*

##### **§ 226.4 [Amended]**

■ 3. Section 226.4(j) is amended by removing the second sentence.

■ 4. Section 226.6 is amended as follows:

■ a. Revise paragraph (b)(1)(xii).

■ b. Amend paragraph (b)(1)(xv) by adding, after the words “board of directors”, the words “or, in the case of a for-profit center that does not have an executive director or is not required to have a board of directors, the owner of the for-profit center”.

■ c. Amend paragraph (b)(1)(xviii) introductory text by adding a sentence at the end.

■ d. Revise paragraphs (b)(1)(xviii)(A)(2), (b)(1)(xviii)(C)(1), (b)(2)(ii), and (b)(2)(iii)(B)(1).

■ e. Amend paragraph (b)(2)(v) by adding, after the words “board of directors”, the words “or, in the case of a for-profit center that does not have an

executive director or is not required to have a board of directors, the owner of the for-profit center”.

■ f. Amend paragraph (b)(2)(vii) introductory text by adding a sentence at the end.

■ g. Revise paragraphs (b)(2)(vii)(A)(2) and (b)(2)(vii)(C)(1).

■ h. Amend paragraph (c)(1)(iii)(A)(5) by removing the word “and” after the semicolon and amend paragraph (c)(1)(iii)(A)(6) by removing the period at the end and adding in its place “; and”.

■ i. Add paragraphs (c)(1)(iii)(A)(7) and (c)(1)(iii)(A)(8).

■ j. In paragraph (c)(1)(iii)(B)(1)(i), remove the word “rescinded” and add in its place the words “temporarily defer”.

■ k. Add paragraph (c)(1)(iii)(B)(3).

■ l. Amend paragraph (c)(2)(iii)(A)(5) by removing the word “and” after the semicolon, and amend paragraph (c)(2)(iii)(A)(6) by removing the period at the end and adding in its place “; and”;

■ m. Add new paragraph (c)(2)(iii)(A)(7).

■ n. In paragraph (c)(2)(iii)(B)(1)(i), remove the word “rescinded” and add in its place the words “temporarily defer”.

■ o. Add paragraph (c)(2)(iii)(B)(3).

■ p–q. Revise paragraph (c)(2)(iii)(D).

■ r. Amend paragraph (c)(3)(iii)(A)(5) by removing the word “and” after the semicolon, and amend paragraph (c)(3)(iii)(A)(6) by removing the period at the end and adding in its place “; and”.

■ s. Add new paragraph (c)(3)(iii)(A)(7).

■ t. In paragraph (c)(3)(iii)(B)(1)(i), remove the word “rescinded” and add in its place the words “temporarily defer”.

■ u. In paragraphs (c)(3)(iii)(B)(1)(ii) and (c)(3)(iii)(B)(2)(iii), remove the word “renewing” and add in its place the word “participating”.

■ v. Add paragraph (c)(3)(iii)(B)(3).

■ w. Revise paragraph (c)(3)(iii)(D).

■ x. In paragraph (c)(6)(ii)(C)(1), remove the word “rescinded” and add in its place the words “temporarily defer”.

■ y. Add paragraph (c)(6)(ii)(C)(3).

■ z. In paragraph (c)(7), remove the word “deny” and add in its place the words “must not approve”.

■ aa. Redesignate paragraphs (k)(3)(iii) and (k)(3)(iv) as paragraphs (k)(3)(iv) and (k)(3)(v), respectively, and add a new paragraph (k)(3)(iii).

■ bb. In newly redesignated paragraph (k)(3)(iv), remove the word “or” after the semicolon; in newly redesignated paragraph (k)(3)(v), remove the period at the end and add in its place a semicolon;

■ cc. Add paragraphs (k)(3)(vi) and (vii).

■ dd. In paragraph (m)(4), remove the words “available enrollment and

attendance records” and add in their place the words “enrollment and attendance records (except in those outside-school-hours care centers, at-risk afterschool care centers, and emergency shelters where enrollment records are not required”.

■ ee. In the first sentence of paragraph (r), add after the word “institution” the words “(other than outside-school-hours care centers, at-risk afterschool care centers, emergency shelters, and adult day care centers)”.

The additions and revisions read as follows:

§ 226.6 State agency administrative responsibilities.

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(xii) Presence on the National disqualified list. If an institution or one of its principals is on the National disqualified list and submits an application, the State agency may not approve the application. If a sponsoring organization submits an application on behalf of a facility, and either the facility or any of its principals is on the National disqualified list, the State agency may not approve the application. In accordance with paragraph (k)(3)(vii) of this section, in this circumstance, the State agency’s refusal to consider the application is not subject to administrative review.

\* \* \* \* \*

(xviii) \* \* \* In ensuring compliance with these performance standards, the State agency should use its discretion in determining whether the institution’s application, in conjunction with its past performance in CACFP, establishes to the State agency’s satisfaction that the institution meets the performance standards.

(A) \* \* \*

(2) Fiscal resources and financial history. A new institution must demonstrate that it has adequate financial resources to operate the CACFP on a daily basis, has adequate sources of funds to continue to pay employees and suppliers during periods of temporary interruptions in Program payments and/or to pay debts when fiscal claims have been assessed against the institution, and can document financial viability (for example, through audits, financial statements, etc.); and

\* \* \* \* \*

(C) \* \* \*

(1) Governing board of directors. Has adequate oversight of the Program by an independent governing board of directors as defined at § 226.2;

\* \* \* \* \*

(2) \* \* \*

(ii) Presence on the National disqualified list. If, during the State agency’s review of its application, a renewing institution or one of its principals is determined to be on the National disqualified list, the State agency may not approve the application. If a renewing sponsoring organization submits an application on behalf of a facility, and the State agency determines that either the facility or any of its principals is on the National disqualified list, the State agency may not approve the application. In accordance with paragraph (k)(3)(vii) of this section, in this circumstance, the State agency’s refusal to consider the application is not subject to an administrative review.

(iii) \* \* \*

(B) \* \* \*

(1) A statement listing any publicly funded programs in which the institution and its principals have begun to participate since the institution’s previous application; and

\* \* \* \* \*

(vii) \* \* \* In ensuring compliance with these performance standards, the State agency should use its discretion in determining whether the institution’s application, in conjunction with its past performance in CACFP, establishes to the State agency’s satisfaction that the institution meets the standards.

(A) \* \* \*

(2) Fiscal resources and financial history. A renewing institution must demonstrate that it has adequate financial resources to operate the CACFP on a daily basis, has adequate sources of funds to continue to pay employees and suppliers during periods of temporary interruptions in Program payments and/or to pay debts when fiscal claims have been assessed against the institution, and can document financial viability (for example, through audits, financial statements, etc.); and

\* \* \* \* \*

(C) \* \* \*

(1) Governing board of directors. Has adequate oversight of the Program by an independent governing board of directors as defined at § 226.2;

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \*

(iii) \* \* \*

(A) \* \* \*

(7) That the institution’s withdrawal of its application, after having been notified that it is seriously deficient, will still result in the institution’s formal termination by the State agency and placement of the institution and its responsible principals and individuals on the National disqualified list; and

(8) That, if the State agency does not possess the date of birth for any individual named as a “responsible principal or individual” in the serious deficiency notice, the submission of that person’s date of birth is a condition of corrective action for the institution and/or individual.

(B) \* \* \*

(3) If the State agency initially determines that the institution’s corrective action is complete, but later determines that the serious deficiency(ies) has recurred, the State agency must move immediately to issue a notice of intent to terminate and disqualify the institution, in accordance with paragraph (c)(1)(iii)(C) of this section.

\* \* \* \* \*

(2) \* \* \*

(iii) \* \* \*

(A) \* \* \*

(7) That, if the State agency does not possess the date of birth for any individual named as a “responsible principal or individual” in the serious deficiency notice, the submission of that person’s date of birth is a condition of corrective action for the institution and/or individual.

(B) \* \* \*

(3) If the State agency initially determines that the institution’s corrective action is complete, but later determines that the serious deficiency(ies) have recurred, the state agency must move immediately to issue a notice of intent to terminate and disqualify the institution, in accordance with paragraph (c)(2)(iii)(C) of this section.

\* \* \* \* \*

(D) Program payments. If the renewing institution’s agreement expires before the end of the time allotted for corrective action and/or the conclusion of any administrative review requested by the participating institution:

(1) The State agency must temporarily extend its current agreement with the renewing institution and continue to pay any valid unpaid claims for reimbursement for eligible meals served and allowable administrative expenses incurred; and

(2) During this period, the State agency may base administrative payments to the institution on the institution’s previous approved budget, or may base administrative payments to the institution on the budget submitted by the institution as part of its renewal application; and

(3) The actions set forth in paragraphs (c)(3)(iii)(D)(1) and (c)(3)(iii)(D)(2) of this section must be taken either until



the serious deficiency(ies) is corrected or until the institution's agreement is terminated, including the period of any administrative review;

\* \* \* \* \*

(3) \* \* \*

(iii) \* \* \*

(A) \* \* \*

(7) That, if the State agency does not possess the date of birth for any individual named as a "responsible principal or individual" in the serious deficiency notice, the submission of that person's date of birth is a condition of corrective action for the institution and/or individual.

(B) \* \* \*

(3) If the State agency initially determines that the institution's corrective action is complete, but later determines that the serious deficiency(ies) has recurred, the State agency must move immediately to issue a notice of intent to terminate and disqualify the institution, in accordance with paragraph (c)(1)(iii)(C) of this section.

\* \* \* \* \*

(D) *Program payments and extended agreement.* If the participating institution must renew its application, or its agreement expires, before the end of the time allotted for corrective action and/or the conclusion of any administrative review requested by the participating institution:

(1) The State agency must temporarily extend its current agreement with the participating institution and continue to pay any valid unpaid claims for reimbursement for eligible meals served and allowable administrative expenses incurred; and

(2) During this period, the State agency may base administrative payments to the institution on the institution's previous approved budget, or may base administrative payments to the institution on the budget submitted by the institution as part of its renewal application; and

(3) The actions set forth in paragraphs (c)(3)(iii)(D)(1) and (c)(3)(iii)(D)(2) of this section must be taken either until the serious deficiency(ies) is corrected or until the institution's agreement is terminated, including the period of any administrative review;

\* \* \* \* \*

(6) \* \* \*

(ii) \* \* \*

(C) \* \* \*

(3) If FNS initially determines that the institution's corrective action is complete, but later determines that the serious deficiency(ies) has recurred, FNS will move immediately to issue a notice of intent to terminate and

disqualify the institution, in accordance with paragraph (c)(6)(ii)(D) of this section.

\* \* \* \* \*

(k) \* \* \*

(3) \* \* \*

(iii) *State agency determination that corrective action is inadequate.* A determination by the State agency that the corrective action taken by an institution or by a responsible principal or individual does not completely and permanently correct a serious deficiency;

\* \* \* \* \*

(vi) *State agency or FNS decision regarding removal from the National disqualified list.* A determination, by either the State agency or by FNS, that the corrective action taken by an institution or a responsible principal or individual is not adequate to warrant the removal of the institution or the responsible principal or individual from the National disqualified list; or

(vii) *State agency's refusal to consider an application submitted by an institution or facility on the National disqualified list.* The State agency's refusal to consider an institution's application when either the institution or one of its principals is on the National disqualified list, or the State agency's refusal to consider an institution's submission of an application on behalf of a facility when either the facility or one of its principals is on the National disqualified list.

\* \* \* \* \*

■ 5. Section 226.7(g) is amended by adding a new fifth and sixth sentence to read as follows:

**§ 226.7 State agency responsibilities for financial management.**

\* \* \* \* \*

(g) \* \* \* If the institution does not intend to use non-CACFP funds to support any required CACFP functions, the institution's budget must identify a source of non-Program funds that could be used to pay overclaims or other unallowable costs. If the institution intends to use any non-Program resources to meet CACFP requirements, these non-Program funds should be accounted for in the institution's budget, and the institution's budget must identify a source of non-Program funds that could be used to pay overclaims or other unallowable costs.

\* \* \* \* \*

**§ 226.10 [Amended]**

■ 6. Section 226.10(c) is amended in paragraph (c)(1) by adding the word "and" after the semicolon at the end of

the sentence, in paragraph (c)(2) by removing the semicolon and the word "and" and adding a period in their place, and by removing paragraph (c)(3).

■ 7. Section 226.11(c)(1) is amended by removing the word "institution" both times it appears and by adding in its place the word "center", and by adding a new last sentence to read as follows:

**§ 226.11 Program payments for centers.**

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \* In the case of a sponsoring organization of family day care homes, each State agency must base reimbursement to each approved family day care home on daily meal counts recorded by the provider.

\* \* \* \* \*

**§ 226.14 [Amended]**

■ 8. In § 226.14, paragraph (a) introductory text is amended in the fourth sentence by removing the words "with the initial demand for remittance" and by adding in their place the words "with the date stipulated in the State agency's demand letter, or 30 days after the date of the demand letter, whichever date is later".

**§ 226.15 [Amended]**

■ 9. Section 226.15 is amended in the first sentence of paragraph (e)(14) by adding the word "annual" after the word "at" and in paragraph (o) by adding the words "(other than outside-school-hours care centers, at-risk afterschool care centers, emergency shelters, and adult day care centers)" after the words "Each institution".

■ 10. Section 226.16 is amended as follows:

■ a. Paragraph (d)(4)(ii) by removing the words "enrollment and/or attendance records" and adding in their place "enrollment and attendance records (except in those outside-school-hours care centers, at-risk afterschool care centers, and emergency shelters where enrollment records are not required)" and by removing the word "children" both times it appears, and by adding the word "participants" in its place.

■ b. Revise paragraph (d)(4)(iv).

■ c. Paragraph (l)(3)(i)(E) by removing "institution's" and adding in its place "sponsoring organization".

■ d. Paragraph (l)(3)(i)(F) by removing "institution" the first time it appears and adding in its place "sponsoring organization" and by removing the words "State institution" and adding in their place the words "sponsoring organization".

■ e. Paragraph (l)(3)(ii) by removing "rescinded" and adding in its place

“temporarily defer” and by adding a new sentence to the end of the paragraph.

The revision and addition read as follows:

**§ 226.16 Sponsoring organization provisions.**

\* \* \* \* \*

(d) \* \* \*

(4) \* \* \*

(iv) *Averaging of required reviews.* If a sponsoring organization conducts one unannounced review of a facility in a year and finds no serious deficiencies (as described in paragraph (l)(2) of this section, regardless of the type of facility), the sponsoring organization may choose not to conduct a third review of the facility that year, and may make its second review announced, provided that the sponsoring organization conducts an average of three reviews of all of its facilities that year, and that it conducts an average of two unannounced reviews of all of its facilities that year. When the sponsoring organization uses this averaging provision, and a specific facility receives two reviews in one review year, its first review in the next review year

must occur no more than nine months after the previous review.

\* \* \* \* \*

(1) \* \* \*

(3) \* \* \*

(ii) *Successful corrective action.*

\* \* \*. However, if the sponsoring organization accepts the provider’s corrective action, but later determines that the corrective action was not permanent or complete, the sponsoring organization must then propose to terminate the provider’s Program agreement and disqualify the provider, as set forth in paragraph (l)(3)(iii) of this section.

\* \* \* \* \*

■ 11. Section 226.18 is amended by revising paragraphs (a)(1) and (b)(1) to read as follows:

**§ 226.18 Day care home provisions.**

\* \* \* \* \*

(a) \* \* \*

(1) It receives title XX funds for providing child care; or

\* \* \* \* \*

(b) \* \* \*

(1) The right of the sponsoring organization, the State agency, the

Department, and other State and Federal officials to make announced or unannounced reviews of the day care home’s operations and to have access to its meal service and records during normal hours of operation.

\* \* \* \* \*

**§ 226.23 [Amended]**

■ 12. Section 226.23 is amended by adding to the first sentence of paragraph (d) the words “public release” after the word “a” the first time it appears.

**§ 226.26 [Amended]**

■ 13. Section 226.26 is amended in paragraph (g) by removing the words “550 Kearney Street, Room 400, San Francisco, California 94108”, and adding in their place the words “90 Seventh Street, Suite 10–100, San Francisco, California 94103–6701”.

Dated: May 25, 2011.

**Kevin Concannon,**

*Under Secretary for Food, Nutrition, and Consumer Services.*

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