DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

7 CFR Part 226

RIN 0584–AC24

Child and Adult Care Food Program; Improving Management and Program Integrity

AGENCY: Food and Nutrition Service, USDA.

ACTION: Interim rule.

SUMMARY: This interim rule incorporates in the Child and Adult Care Food Program regulations the changes proposed by the Department in a rulemaking published on September 12, 2000. These changes result from the findings of State and Federal Program reviews; from audits and investigations conducted by the Office of Inspector General; and from amendments to the Richard B. Russell National School Act enacted in the Healthy Meals for Healthy Americans Act of 1994, the Personal Responsibility and Work Opportunities Reconciliation Act of 1996, and the William F. Goodling Child Nutrition Reauthorization Act of 1998. This rule revises State agency criteria for approving and renewing institution applications; certain State- and sponsor-level monitoring requirements; and Program training and other operating requirements. Additional statutory changes resulting from enactment of the Agricultural Risk Protection Act of 2000 and the Grain Standards and Warehouse Improvement Act of 2000 were addressed in a separate interim rule published on June 27, 2002. The changes in this interim rule are primarily designed to improve Program operations and monitoring at the State and institution levels and, where possible, to streamline and simplify Program requirements for State agencies and institutions.

DATES: This interim rule is effective October 1, 2004. The following provisions must be implemented no later than April 1, 2005: §§ 226.6(f)(1)(x), 226.6(m)(5), 226.15(e)(2) and (e)(3), and 226.18(e). The following provisions must be implemented no later than October 1, 2005: §§ 226.7(k), 226.10(c), 226.11(b), and 226.13(b). To be assured of consideration, comments must be postmarked on or before September 1, 2005. Comments will also be accepted via E-Mail submission if sent to *CNDPROPOSAL@FNS.USDA.GOV* no later than 11:59 p.m. on September 1, 2005.

ADDRESSES: The Food and Nutrition Service invites interested persons to submit comments on this interim rule. Comments may be submitted by any of the following methods:

- E-Mail: Send comments to *CNDPROPOSAL@FNS.USDA.GOV*
- Fax: Submit comments by facsimile transmission to: (703) 305–2879, attention Robert Eadie.
- Mail: Comments should be addressed to Mr. Robert Eadie, Chief, Policy and Program Development Branch, Child Nutrition Division, Food and Nutrition Service, Department of Agriculture, 3101 Park Center Drive, Room 634, Alexandria, Virginia 22302–1594. All written submissions will be available for public inspection at this location Monday through Friday, 8:30 a.m.–5 p.m.
- Hand Delivery or Courier: Deliver comments to 3101 Park Center Drive, Room 634, Alexandria, Virginia 22302–1594, during normal business hours of 8:30 a.m.ndash;5 p.m.
- Federal eRulemaking Portal: Go to *http://www.regulations.gov.* Follow the online instructions for submitting comments.

FOR FURTHER INFORMATION CONTACT: Mr. Edward Morawetz or Mr. Keith Churchill at the above address or by telephone at (703) 305–2590. A regulatory impact analysis was completed as part of the development of this interim rule. Copies of this analysis may be requested from Mr. Morawetz or Mr. Churchill.

SUPPLEMENTARY INFORMATION:

Background

Why Is This Rule Being Issued as an Interim Rule, Rather Than as a Final Rule?

As noted, USDA published a proposed rulemaking on September 12, 2000 (65 FR 55101). That proposed rule responded to State and Federal Program reviews which found numerous cases of mismanagement and Program abuse by child care sponsors and facilities. In addition, audits and investigations conducted by the Office of Inspector General (OIG) had raised serious concerns regarding the adequacy of financial and administrative controls on the Child and Adult Care Food Program (CACFP). As originally drafted, the proposed rulemaking presented a large number of changes designed to improve Program management and integrity in the CACFP.

In the spring of 2000, shortly before the proposed rule was published, the Agricultural Risk Protection Act of 2000 (ARPA) was enacted. ARPA included a number of nondiscretionary provisions affecting CACFP and requiring implementation. As a result, we published the September 2000 proposed rule featuring discretionary changes to CACFP, and then subsequently published an interim rule on June 27, 2002, implementing the nondiscretionary provisions mandated by ARPA (67 FR 43447). Due to the timing of ARPA's enactment and the subsequent publication of the proposed rule, those who commented on the proposed rule were largely unaware of the way in which the provisions of ARPA would interact with the discretionary regulatory proposals for CACFP published in September 2000.

We are publishing this interim rulemaking in order to provide a fuller opportunity for the public to comment on the interactions between the provisions of the proposed rule (which are included in this interim rule) and the interim rule subsequently published on June 27, 2002. After receiving public comment, we intend to publish a single CACFP final rule.

Why Did OIG Conduct These Audits and Investigations?

The Food and Nutrition Service (FNS) asked OIG to conduct an audit of the family day care home component of CACFP because of the results of State and Federal Program reviews. In its first audit, OIG selected five States for inclusion based on the States' total family day care home sponsor and provider enrollment, Program costs, and geographic location. Then, it randomly selected family day care home sponsors and providers within those five States to be included in the audits.

What Did the First OIG Audit Reveal?

In 1995, OIG released a report (No. 27600–6–At) that presented the results of these five audits. The audits evaluated:

- The adequacy of FNS, State agency, and family day care home sponsors' financial and administrative controls over meal claims;
- The accuracy of Program and participation data and claims for reimbursement submitted by family day care home sponsors; and
- Whether State agencies and participating sponsors complied with applicable laws, regulations, and guidance.

These audits found serious types of regulatory noncompliance by both sponsors and homes, including:

- Meals claimed for absent children;
- Meals claimed for nonexistent homes and children;
- Lack of documentation for meal counts and/or menu records;

• Failure by sponsors to perform required monitoring visits; and
• Sponsors' failure to require providers to attend training.

What Were OIG's Recommendations to FNS in the 1995 Audit?

Based on its findings, OIG's 1995 audit recommended changes to CACFP review requirements and management controls. In total, the 1995 audit made fifteen recommendations. We have completed action on the five OIG recommendations from the national audit that did not require regulatory change. The other ten recommendations require regulatory changes, most of which are addressed in this preamble.

The most significant recommendations from the 1995 audit were that the CACFP regulations be amended to require that:

• Sponsors and State agencies make unannounced reviews of day care homes;
• Parental contacts be made in order to verify children's Program participation;
• Sponsor reviews of day care homes include, at a minimum, reconciliation of enrollment, attendance, and meal claim data;
• All family day care home providers receive training each year; and
• All State agency reviews include certain specified review elements.

Recommendations from the 1995 audit that were included as statutory provisions in ARPA (for example, the requirement that sponsoring organizations make unannounced reviews of their facilities) were addressed in the previously-mentioned interim rule published on June 27, 2002.

Has OIG Conducted Other Audits As Well?

OIG conducted additional audits of family day care home and child care center sponsors, many of which State or Federal Program administrators had suspected of having serious management problems. These targeted audits, released in August of 1999 and were referred to collectively as ''Operation Kiddie Care'' by OIG, confirmed the findings of the 1995 audits and developed additional findings as well.

Is the Department Including in This Rule Any of the Recommendations From OIG's 1999 ''Operation Kiddie Care'' Audit?

Most of the ''Operation Kiddie Care'' audit's recommendations for regulatory changes also appear in this rule. As mentioned above, those changes that are not addressed here were included in the June 27, 2002, interim rule, due to the fact that they were mandated by ARPA.

Is There Any Recommendation From the Operation Kiddie Care Audit Not Included in Either Interim Rule?

Yes. We have not incorporated, either in this or the earlier interim rule, the audit's recommendation for a major Program design change in the way that sponsoring organizations of family day care home sponsors are reimbursed for their administrative expenses.

The current administrative reimbursement system for family day care home sponsors sets a cap on administrative expenses that is based on the total number of homes sponsored. Home sponsors are paid the lesser of: The number of homes administered times a per home administrative rate; actual administrative costs; or the sponsor's approved budget. Thus, because operating the Program in a larger number of homes raises the ceiling on the sponsor's maximum administrative earnings, some observers believe that there is a built-in financial incentive for day care home sponsors to administer the Program in more homes, and a built-in financial disincentive for sponsors to terminate homes' CACFP participation, even if the homes are doing a poor job of administering the Program.

The management improvement training provided to State Program administrators in 1999–2000, and the interim rule published in 2002, addressed this problem by providing State agencies with the tools to perform better and more thorough reviews of institutions' budgets and sponsors' management plans. Specifically, the performance standards mandated by ARPA should result in more thorough State agency reviews of institution applications which, consequently, should also help limit sponsors' administrative costs to those expenses that are reasonable and necessary for Program administration, regardless of the ceiling resulting from the homes times rates calculation.

However, at the time that the proposed rule was issued, these performance standards had not been fully implemented. For that reason, we asked readers of the proposed rule to comment on several possible alternatives to the current system of administrative reimbursement for day care home sponsors. These alternatives had been discussed with stakeholders during development of the proposed rule, and included:

• Eliminating homes times rates as a component of the administrative cost system, instead paying sponsors the lesser of actual costs or approved budget amounts;
• Establishing a fixed percentage of the meal reimbursement distributed to providers as the sponsor's administrative payment. In other words, if a sponsor disbursed $300,000 per month in meal reimbursements to its providers, it would receive, in addition to the $300,000 in meal reimbursements for its providers, up to some fraction (perhaps 10 to 15 percent) of that amount to cover all of their approved and allowable administrative expenses;
• Paying sponsors a fixed administrative fee for each reimbursable meal served by their providers;
• Lowering the per home administrative rates for sponsors of more than 200 homes, in order to reduce their financial incentive to sponsor more homes; and
• Establishing some other system of administrative reimbursement for home sponsors that commenters might recommend.

How Did Commenters Respond to These Possible Alternative Systems of Administrative Reimbursement for Day Care Home Sponsors?

A total of 484 commenters responded to our request for comments on these alternatives to the current administrative reimbursement system. After analyzing these comments, we have determined that no change to the current administrative reimbursement structure is warranted.

How Many Comments Did the Department Receive?

We Received a Total of 548 Comments on the Proposed Rule.

Who Commented on the Rule?

Of the 548 comments received, 353 were from individuals associated with institutions participating in CACFP (either independent centers or sponsoring organizations of homes or centers); 67 were from family day care home providers participating in the Program; 54 (representing 36 different States) were from State Program directors and their staffs; 21 were from State or National CACFP or children's advocacy organizations; and 53 were from parents, students, nutritionists, or other interested individuals whose institutional affiliation could not be determined.

How Is the Remainder of This Preamble Organized?

The preamble is divided into four parts, and follows the same organization used in both the proposed rule and the interim rule published on June 27, 2002:

I. State agency review of institutions' Program applications;
II. State agency and institution monitoring requirements;
III. Training and other operational requirements; and
IV. Other provisions mandated by the Healthy Meals for Healthy Americans Act of 1994 (Pub. L. 103–448, hereinafter referred to as the Healthy Meals Act); the Personal Responsibility and Work Opportunities Reconciliation Act of 1996 (Pub. L. 104–193, hereinafter referred to as PRWORA); and the William F. Goodling Child Nutrition Reauthorization Act of 1998 (Pub. L. 105–336, hereinafter referred to as the Goodling Act). Readers of this preamble should note that none of the changes mandated by Public Law 108–265, the Child Nutrition and WIC Reauthorization Act of 2004, is included in this rule. These changes will all be incorporated in one or more future rules.

While many of the changes discussed in parts I–III of this preamble are discretionary changes designed to improve Program management and streamline Program operations, we also included a number of changes to the CACFP regulations required by the Healthy Meals Act, PRWORA, and the Goodling Act. Most of the mandatory changes are located in part IV of this preamble, though some appear in other parts of the preamble, depending on whether the specific statutory change under consideration was thematically related to the discretionary changes being discussed in another part of the preamble. Non-discretionary provisions (*i.e.*, changes based on a statutory mandate) will be identified in the preamble discussion.

Part I. State Agency Review of Institutions' Program Applications

A. State Agency Review of a New Institution's Application

What does the NSLA Say With Regard to the Duration of an Application?

Section 204(a)(3) of the Child Nutrition and WIC Reauthorization Act of 1989 (Pub. L. 101–147) amended section 17(d) of the Richard B. Russell National School Lunch Act (NSLA; 42 U.S.C. 1766(d)) by adding a new paragraph (2)(A) which requires the Department to ''develop a policy that allows institutions providing child care * * *, at the option of the State agency, to reapply for assistance * * * at 2-year intervals.'' It also required that State agencies choosing this option must ''confirm on an annual basis'' that each participating institution is in compliance with the licensing and approval requirements set forth at section 17(a)(1) of the NSLA (42 U.S.C. 1766(a)(1)). Later, section 116(b) the Healthy Meals Act amended section 17(d)(2)(A) (42 U.S.C. 1766(d)(2)(A)) of the NSLA by extending the two-year CACFP reapplication interval to three years.

Were Three-Year and One-Year Applications the Only Options Addressed in the Proposed Rule?

No. Although the NSLA requires reapplication for participation at least once every three years, it does not require annual or biennial applications to be the only alternatives to the triennial option. Therefore, we proposed to remove the references to an annual application found in the introductory paragraphs of § 226.6(b) and 226.6(f), and in § 226.7(g), and to further revise § 226.6(b) to require each institution to reapply for participation at a time determined by the State agency, as long as not less than one nor more than three years have elapsed since its last application approval. This gives State agencies the *option* to consider whether the annual renewal of applications represents the most efficient and effective means of carrying out their Program responsibilities, and to consider any length of application between 12 and 36 months. In addition, we proposed that, if an institution submits a renewal application, and the State agency has not conducted a review of that institution since the last agreement was signed or extended, but has reason to believe that such a review is immediately necessary, the State agency has the option of approving the institution's application for a period of less than one year, pending the completion of such a review.

How Did Commenters' Respond to These Proposals?

Overall, commenters were in favor of our interpretation of the NSLA's intent—that State agencies should have the flexibility to require institutions to submit re-applications at any time between one and three years after the previous application. In total, 47 respondents (19 State agencies, 14 sponsors or other institutions, 9 National or State organizations, 3 providers, and 2 commenters whose organizational affiliation was unclear) commented specifically on this provision, and all but one (who wanted a 2-year maximum on applications, although the NSLA now permits up to three years at State agency discretion) were in favor of our interpretation. In addition, we received about 350 general comments commending the proposal's increased flexibility regarding applications, which in part refers to our proposals to lengthen the time between applications and to reduce the amount of information required to be re-submitted on renewal applications.

However, although there was consensus that 12 months should generally be the minimum amount of time between applications, there was some disagreement about the circumstances warranting a State agency's occasional use of a less-than-12-month period before requiring a re-application. As previously mentioned, § 226.6(b)(1)(ii)(C) of the proposed rule required State agencies to establish re-application periods of between 12 and 36 months for renewing institutions except in one instance: When the State agency has not conducted a review of that institution since the last application was approved, but has reason to believe that such a review is immediately necessary. This might occur, for example, when a State agency was reviewing a sponsoring organization's re-application, the sponsor had not been reviewed during the period of its prior application, and the State agency had concerns about the sponsor's management practices.

Six State agency staff commented on this provision, and five of them wanted us to permit State agencies to renew contracts for less than 12 months under other circumstances as well. These five commenters believed that the CACFP regulations should provide State agencies with the flexibility to determine whether there are unusual circumstances warranting the use of a less-than-12-month reapplication period. We appreciate State agencies' desire for maximum flexibility. We do not believe that requiring an institution to re-apply in less than 12 months should be a frequent occurrence. However, State agencies' experience with circumstances warranting more frequent scrutiny of institutions' applications indicate a need for greater flexibility. We are, therefore, convinced that there may be unusual circumstances in which a re-application in less than 12 months could be warranted.

Accordingly, we have removed reference to the single circumstance warranting a reapplication period of less than 12 months, and substituted language clarifying that, under unusual circumstances, a State agency may require an institution to re-apply in less than 12 months. As a result of the re-organization of this section of the regulations by the interim rule published on June 27, 2002, and the further reorganization of § 226.6(b) made in this rule in order to combine the application provisions of the two rules, the provision now appears in the

introductory paragraph of § 226.6(b)(2), with regard to renewal applications, and at § 226.6(b)(4)(ii)(B), with regard to the length of the agreement. Readers should again note that the interim rule published on June 27, 2002, specifically requires at § 226.6(c)(2)(iii)(D) the use of short-term extensions of an agreement when the State agency denies a renewal application or discovers a serious deficiency during its review of an applicant's renewal application.

Did the Department Propose Other Changes Related to the Application Process? What Were Commenters' Responses to These Provisions?

Yes. We proposed six additional changes to the rules governing institution applications. Five of these are discussed below, while the sixth is addressed in part I(B) of this preamble.

(1) Reorganization of application requirements at § 226.6(b) and 226.6(f).—First, we proposed reorganizing § 226.6(b) and 226.6(f), so that § 226.6(b) sets forth the broad requirements for applications submitted by institutions, and § 226.6(f) specifies the frequency at which the institution would be required to update the licensing and approval information, as required by law, as well as other information contained in its original application. Respondents to the proposed rule did not comment on this proposed organizational change, and it therefore appears in this interim rule substantially as it was presented in the proposed rulemaking (except that § 226.6(b) has been further re-organized to accommodate the regulatory distinction between new and renewing institutions that is incorporated in this rule. *See* paragraph (3), below).

(2) Reorganization of other application requirements.—Current Program regulations at §§ 226.6(b), 226.6(f), 226.7(g), 226.15(b), 226.16(b) and 226.23(a) all establish various requirements for Program applications. Current §§ 226.6(f)(1), (f)(2), and (f)(3), and current 226.7(g) expand upon the requirements of § 226.6(b)(1), (b)(5), and (b)(6) by describing the information to be included in the Program agreement and the management plan, and by establishing requirements pertaining to the State agency's review and approval of the sponsoring organization's management plan and the institution's budget. Section 226.15(b) reiterates the annual institution application requirements set forth in § 226.6(b) and requires that nonprofit institutions submit evidence of their tax exempt status in accordance with § 226.15(a). Section 226.16(b) reiterates the annual application requirements pertaining to sponsoring organizations, and § 226.23(a) requires that each institution submit, and that State agencies approve, as part of the annual application process, a free and reduced-price policy statement to be used in all child care and adult day care facilities under the institution's supervision.

We proposed to consolidate more of these requirements in § 226.6(b) so that State agencies and institutions could more easily refer to them during the application process. Respondents to the proposed rule did not comment on this proposed organizational change, and it therefore appears in this interim rule substantially as it was presented in the proposed rulemaking (except that § 226.6(b) has been further re-organized to accommodate the regulatory distinction between new and renewing institutions that is incorporated in this rule. *See* paragraph (3), below).

The proposed modifications to the wording of the application requirements set forth in current § 226.6(b)(1) through (b)(18) were necessitated by the distinctions being drawn between new applicants and renewing institutions. In addition, we proposed to modify current § 226.6(b)(10) (which requires the institution to state on its application whether it wishes to receive a full, partial, or no advance payment) due to PRWORA's change to the requirement that State agencies make advance payments available to Program institutions upon request. Furthermore, under our proposed revision to the application process, State agencies would continue to be responsible for distributing to, and collecting from, participating institutions certain Program information and data, and for ensuring that the CACFP is being operated in compliance with all regulatory requirements. In the proposed rule, these additional State agency responsibilities for information collection or dissemination outside of the application process were grouped into three paragraphs within revised and reorganized § 226.6(f). Section 226.6(f)(1) would delineate responsibilities, including the collection or distribution of certain information, which State agencies would be required to perform annually; § 226.6(f)(2) would list State agency responsibilities to be performed at least once every three years; and § 226.6(f)(3) would enumerate those State agency responsibilities that could be carried out at intervals established at the State agency's discretion, though not more frequently than annually.

(3) Distinction between application requirements for new and renewing institutions.—We also proposed to differentiate between the application requirements for ''new'' and ''renewing'' institutions. We did so because our experience, and that of our State agencies, indicates even greater attention needs to be paid to the applications of those institutions applying for the first time and those re-entering the Program after a lapse in participation, so that they will successfully operate the Program from the start. The need to ensure that new applicant institutions are brought into the Program successfully is best served by a regulation that establishes specific minimum requirements for applications submitted by new institutions, but that allows State agencies greater flexibility in dealing with renewal applications. To that end, the proposed rule included very specific application requirements for new institutions but, for renewing institutions, proposed to specify primarily that the reapplication be evaluated on the basis of the institution's ability to properly operate the Program in accordance with the performance standards, as demonstrated in its management plan (if the institution is a sponsoring organization), its budget, and its prior record in operating the Program.

All 21 respondents who commented on this provision (17 State agencies, 3 sponsors or other institutions, and 1 State organization) were in favor of this change. Because it was necessary to create a regulatory distinction between new and renewing institutions in order to fully implement some of the institution eligibility provisions of ARPA, we have already included these definitions at § 226.2 of the regulations in the interim rule published on June 27, 2002. As a result of this rule's interaction with the 2002 interim rule, this rule also requires that the renewal application include information on the past performance, criminal conviction, and presence on the National Disqualified List of the institution or its principals.

As a further result of the interaction between the two interim rules, and in order to fully incorporate the distinctions between new and renewing institutions in the regulatory text on application review, the specific application requirements now appear at § 226.6(b)(1) and (b)(2) of this interim rule for new and renewing institutions, respectively. This means that the annual regulatory requirements for all applications that currently appear at § 226.6(b)(2) through (b)(18) are reorganized by this rule into requirements for new and renewing institutions at § 226.6(b)(1) and (b)(2), respectively; the requirements for State

agency notification of applicants that currently appear in the introductory paragraph of § 226.6(b) are relocated by this rule to § 226.6(b)(3); and the provisions on agreements that currently appear at § 226.6(b)(1) and 226.6(f)(1) are relocated by this rule to § 226.6(b)(4). Finally, the basic requirement that State agencies establish an application process, and the general requirements for that process, are still included in the introductory text of § 226.6(b).

The movement of the application and agreement requirements formerly located at § 226.6(f) to § 226.6(b) of this rule allows us to use the new § 226.6(f) primarily as a place to specify the intervals at which a State agency must disseminate information to, or collect information from, participating institutions, regardless of the interval at which the State agency has opted to require re-applications. For example, if a State agency chose to require that sponsoring organizations reapply every two years, it would still be required to collect a budget from each sponsoring organization annually, in accordance with § 226.6(f)(1).

(4) Requirement that State agencies consult the National disqualified list.—The results of OIG audits have convinced us that State agencies must be explicitly required to consult the National disqualified list (previously called the seriously deficient list but renamed in the interim rule published on June 27, 2002) when reviewing any institution's new or renewal application for participation. In several instances, OIG found that an institution or individual terminated from CACFP for cause and placed on the National disqualified list by one State was subsequently approved to participate by another State. Therefore, we proposed regulatory language to require a State agency to consult the National disqualified list whenever it reviews any institution's new or renewal application, and to deny the institution's application if either the institution, or any of its principals, is on the National disqualified list. [Please note that the June 27, 2002, interim rule requires State agencies to consult the National disqualified list when sponsors apply on behalf of facilities as well.]

A total of 15 respondents (14 State agencies and one sponsor/institution) commented on this proposed change. While all were supportive of this provision, nine of the commenters expressed reservations about the practicality of using the National disqualified list for this purpose. Their primary objection was that the current hard-copy (paper) version of the list was lengthy, poorly organized, and difficult to use. However, since those comments were submitted, we have addressed this issue by developing an electronic version of the National disqualified list and making it available to State agencies and sponsoring organizations.

Because the consequence of an institution or individual being on the National disqualified list had to be clarified in the first interim rule published on June 27, 2002, as part of the full implementation of ARPA, that rule required (at § 226.6(b)(12)) a State agency to consult the National disqualified list whenever it reviews any institution's application to participate and to deny the institution's application if either the institution, or any individual associated with the institution in a principal capacity, is on the National disqualified list. In the proposed rule published on September 12, 2000, this provision had been placed at § 226.6(b)(1). In this interim rule, which further re-organizes § 226.6(b), that provision will now appear at § 226.6(b)(1)(xi) and (b)(2)(ii) for new and renewing institutions, respectively.

(5) Length of Program agreements between State agencies and institutions.—Under the current regulations at § 226.6(b)(1) and 226.6(f)(1), renewal of an institution's Program agreement is required as part of the annual reapplication process. These provisions were established prior to the legislative change to section 17 of the NSLA that now gives State agencies the option to take applications from participating institutions no less frequently than every three years.

Prior to the enactment of the Goodling Act, the NSLA did not specify the duration of the Program agreement between the State agency and the institution. However, section 102(d) of the Goodling Act amended section 9(i) of the NSLA (42 U.S.C. 1758(i)) to require a State agency that administers any combination of the child nutrition programs (*i.e.*, the National School Lunch, School Breakfast, Child and Adult Care Food or Summer Food Service Programs) to enter into a single permanent agreement with a school food authority that administers more than one of these programs. The NSLA does not specify the duration of the agreement between the State agency and non-school institutions.

Consistent with section 17(d)(2) of the NSLA (42 U.S.C. 1766(d)(2)), which permits State agencies to take applications every three years, we proposed that Program agreements for non-school institutions should be in effect for the period of the institution's application approval (*i.e.*, generally, for a period between one and three years). Therefore, the proposed rule continued to link the length of the Program application and agreement for non-school institutions, while requiring State agencies to enter into permanent agreements with institutions that are schools and that, in accordance with the Goodling Act, operate more than one child nutrition program administered by the same State agency. (Readers should note that the recent legislative change requiring permanent agreements between sponsoring organizations and family day care homes is not addressed in this interim rule, but will be included in a subsequent rulemaking.)

A total of 369 comments were received on this provision. These responses came from 18 State agency commenters, 241 sponsoring organizations and other institutions, 10 State and National organizations, 57 providers, and 43 commenters whose organizational affiliation could not be determined. The vast majority of commenters (363 out of 369) believed that we should reconsider the possibility of having permanent agreements for all types of institutions participating in CACFP. Primarily, these respondents noted that the existence of a permanent agreement was a small but meaningful reduction of paperwork for State agencies and institutions. In addition, some State agency commenters noted the potential difficulty of having as many as three different lengths of agreement in effect for different types of institutions (*e.g.*, permanent where required by the Goodling Act, one-year agreements with sponsoring organizations, and three-year agreements with independent centers) if this provision were implemented as proposed.

The primary reason that we proposed to have agreements expire at the time of application renewal was our belief that not renewing an agreement linked to a denied re-application would be less procedurally burdensome to State agencies than going through the serious deficiency process. However, in drafting the interim rule implementing the CACFP changes mandated by ARPA, we determined that section 17 of the NSLA now requires State agencies to follow the same procedures for denying renewal applications as for terminating a participating program. That is, if a re-applying institution were determined to be seriously deficient during the review of its application, it would still have the opportunity to take corrective action. Then, if corrective action was not taken, the State agency would propose to terminate the institution's agreement, and the institution would have an

opportunity for an administrative review prior to the State's formal termination of the agreement. During this period, the institution's agreement would be temporarily extended for a brief period, until the completion of the administrative review. Similarly, if the State agency denied the renewal application for reasons unrelated to a serious deficiency (*e.g.*, the institution failed to submit all required information in its renewal application), the institution's agreement would be temporarily extended until the completion of the administrative review. Thus, as a result of the changes mandated by ARPA, it is no easier to terminate an institution's participation by denying their renewal application than by terminating their participation in the middle of an agreement. Therefore, there is no compelling reason to link the time interval between application and re-application to the length of the agreement.

Accordingly, this interim rule modifies § 226.6(b)(4)(ii) [proposed § 226.6(b)(2)(ii)] to permit State agencies to enter into permanent agreements with any institution, and to require a single permanent agreement between the State agency and any school food authority that administers more than one child nutrition program. Also, the requirements pertaining to the minimum length of the agreement have been modified to accommodate the possible need for short-term extensions of the agreement during an institution's appeal of an application denial or a proposed termination, in cases where the State agency chooses not to utilize a permanent agreement.

Did You Receive Comments on Any of Your Proposed Changes to the Application or Related Requirements at Current § 226.6(b) and 226.6(f) for New and Renewing Institutions?

Yes. The comments on these proposed changes and our responses are detailed below.

Current § 226.6(b)(1): Program agreement [proposed § 226.6(b)(2)].— *See* the previous discussion concerning the length of the Program agreement entered into between the State agency and institutions.

Current § 226.6(b)(2): Center requirements pertaining to free and reduced-price eligibility [proposed § 226.6(b)(1)(i)(A) and 226.6(f)(1)].— The current regulations at § 226.6(b)(2) require that centers submit current free and reduced-price eligibility information annually. We proposed that new independent centers and new sponsors of centers would continue to be required to submit such information to the State agency with their initial application. In addition, we proposed that collection of this information by the State agency would be required annually at proposed § 226.6(f)(1), to enable the State agency to use this information to construct an annual claiming percentage or blended rate for each participating child care center in accordance with § 226.9(b).

We received two comments on these proposed changes, both from State agencies. One favored the change stating that, since the information is reported at least annually to enable the calculation of a blended rate or claiming percentage, it is not necessary that it be included in a renewal application. A second commenter expressed reservations about the requirement for new centers to include this information with the application, stating that the center would not know its numbers at the time it applied. However, we concluded that this information would have to be known by the center sometime during the application process, prior to the execution of a formal agreement between the center and the State agency, so that accurate claims could be submitted.

Accordingly, we have adopted this regulatory language as proposed in this interim rule. The provision will appear at § 226.6(b)(1)(i) for new institutions. Although renewing institutions will not be specifically required to include this information on their renewal applications, the State agency will be required to collect the information annually in accordance with § 226.6(f)(1)(v), in order to construct a blended rate or claiming percentage for each center.

Current § 226.6(b)(3) and 226.6(f)(11): Family day care home sponsoring organization requirements for submission of enrollment information [proposed § 226.6(b)(1)(i)(B)].— Current § 226.6(b)(3) requires sponsors of family day care homes to annually provide aggregate enrollment information for the homes they sponsor and to confirm the eligibility of providers' children for free and reduced-price meals. We proposed that this requirement would be maintained for new sponsoring organizations of family day care homes. New family day care home sponsors would be required to provide an estimate of their annual aggregate enrollment for planning purposes. Meanwhile, State agencies could choose to include or exclude this requirement from sponsoring organizations' renewal applications. We proposed to delete the annual data reporting requirements pertaining to tier I and tier II homes and meals at current § 226.6(f)(11). The fact that this more detailed information on home participation (children in tier I, tier II, and mixed homes) is now collected monthly, on the FNS–44 form, means that sponsoring organizations already fulfill this requirement.

Again, we received two comments on these proposed changes, both from State agencies. One commenter stated that we should follow the same approach for centers and homes, which we did (new institutions include this information on their initial application, renewing institutions do not do so because the information is already being captured on monthly reports for homes and annually for centers). The other commenter expressed reservations about the requirement for new home sponsors to include this information with the application, stating that the new home sponsor would not know these numbers at the time it applied. However, new family day care home sponsors must have an accurate count of homes in order to make administrative budget projections and to demonstrate that they will have adequate revenue, from administrative reimbursement and any other sources, to be financially viable. Although enrollment information on the children participating in each of these homes will fluctuate, it will nevertheless be available sometime during the application process, either at the time the new sponsor submits an application or, at the least, prior to the beginning of their actual Program participation. The regulation will, therefore, require a new home sponsor to include this information as part of its initial application.

Accordingly, we have adopted this regulatory language as proposed in this interim rule. In this interim rule, which further re-organizes § 226.6(b), the provision will appear at § 226.6(b)(1)(ii) for family day care home sponsors. Renewing home sponsors will not be specifically required to include this information on their renewal applications. They will, of course, be annually required to estimate the number of homes they will sponsor in the coming year in order to revise their administrative budget.

Current §§ 226.6(b)(4), 226.15(b)(5), and 226.23(a): Nondiscrimination policy statement and media release [proposed §§ 226.6(b)(1)(i)(C), 226.6(b)(1)(ii)(B), 226.6(f)(1)(vii), 226.6(f)(3)(iii), and 226.23(a)].— Current §§ 226.6(b)(4), 226.15(b)(5), and 226.23(a) require the submission of a nondiscrimination policy statement, a free and reduced-price policy statement, and a media release as part of the annual application. The wording of this requirement was altered slightly in the

proposed rule to require that each new institution submit its free and reduced-price policy statement, its nondiscrimination policy statement, and a copy of its media release announcing the Program's availability. Because section 722 of PRWORA prohibited institutions from being required to re-submit the policy statement unless it was substantively changed, proposed § 226.6(b)(1)(ii)(B) prohibited State agencies from requiring resubmission of the free and reduced-price policy statement in the renewal application unless the institution made substantive changes to the statement. However, we also proposed that all institutions would continue to be required at § 226.6(f)(1)(vii) to annually submit to the State agency documentation that they had issued a media release which informed the public of the Program's availability, and State agency collection of the nondiscrimination statement would be done on an as needed basis (*i.e.*, only when the institution made substantive changes) under proposed § 226.6(f)(3)(iii). The relocation of these requirements to § 226.6(f) also allowed us to propose deletion of the current requirements at § 226.15(b)(5). Finally, § 226.23(a) proposed to eliminate the requirements for the institution to submit a free and reduced-price policy statement in its renewal application, in order to conform to the requirements of PRWORA.

We received a total of eight comments on these proposals, seven from State agencies and one from a sponsor/institution. All eight commenters approved of these proposed changes, but suggested modifications to the regulatory wording. Seven of these respondents stated that the regulations should explicitly provide State agencies with the option to issue a Statewide media release on behalf of all institutions in the State. We addressed this issue in guidance dated September 18, 1996, but we agree that it also makes sense to include reference to this option in the regulatory language. Another commenter pointed out that, although our preamble discussion spoke of limiting changes to the nondiscrimination statement to times when the institution's policy changed, the regulatory language itself permitted State agencies to ask for an updated nondiscrimination statement on an as-needed basis, which could be as often as annually. We agree with this commenter that there is no compelling reason for the State agency to require this document to be submitted more frequently than the free and reduced-price policy statement (*i.e.*, only when the institution makes changes to the nondiscrimination statement). For that reason, we have removed reference to the nondiscrimination statement that had appeared at proposed § 226.6(f)(3)(iii).

Accordingly, this interim rule incorporates these modifications as described above. In this interim rule, which further re-organizes § 226.6(b), the application requirements for submission of a nondiscrimination statement and a media release by new institutions will appear at § 226.6(b)(1)(iii). This section of the rule, as well as §§ 226.6(f)(1)(vii) and 226.23(d), will also specifically acknowledge that State agencies may either require institutions to issue an annual media release, or may issue a Statewide media release on behalf of all their institutions. State agencies will be prohibited (at §§ 226.6(b)(2), introductory paragraph, and 226.23(a)) from requiring an institution to submit, as part of a renewal application, an updated nondiscrimination statement or a free and reduced-price policy statement, unless the institution makes changes to either statement. This would not, of course, prevent a State agency from asking for copies of these items during reviews or at other appropriate times.

Current § 226.6(b)(5) and 226.6(f)(2): Sponsoring organization management plans [proposed § 226.6(b)(1)(i)(D), 226.6(b)(1)(ii)(A)(1) and 226.6(f)(2)(ii)].—The current requirement at § 226.6(b)(5), under which sponsoring organizations must annually submit a complete management plan as part of their application, was moved to proposed § 226.6(b)(1)(i)(D), governing the submission of applications by new institutions, as was the substance of current § 226.6(f)(2), which details the specific elements which must be included in a sponsor's complete management plan. Because it is such a critical document in establishing a sponsoring organization's ability to meet the statutorily-mandated eligibility criteria of financial viability, administrative capability, and internal controls for accountability, we also proposed to specifically require that a complete management plan again be submitted as part of sponsoring organizations' renewal applications. This requirement was at proposed §§ 226.6(b)(l)(ii)(A)(l) and 226.6(f)(2)(ii).

Because of this proposal to require submission of a complete management plan with the renewal application, we proposed to leave more frequent submissions of a partial or complete management plan to the State agency's discretion, and to include the requirement to submit the complete management plan as part of the renewal application at revised §§ 226.6(b)(2)(i) and 226.6(f)(2)(ii). This means that each State agency would be required to collect a complete management plan from sponsors no less frequently than every three years, but could require submission of the complete management plan as often as annually. The only portion of the management plan that this rule requires to be updated annually is the sponsoring organization's administrative budget, as discussed below. Of course, justification for changes to a sponsoring organization's budget assumptions might also require amendments to other portions of the management plan dealing with staffing, projected growth or decline in the number of facilities sponsored, or other factors.

We received no specific comment on this reorganization or on the requirements pertaining to the periodic submission of management plans. Accordingly, this interim rule incorporates the changes proposed with regard to State agency review of management plans. Because of the further reorganization of § 226.6(b) in this interim rule, these provisions now appear at §§ 226.6(b)(1)(iv), 226.6(b)(2)(i), and 226.6(f)(2)(ii).

Current §§ 226.6(b)(6), 226.6(b)(18)(i)(C), 226.6(f)(3), 226.7(g), and 226.15(b)(3): Institutions budgets [proposed §§ 226.6(b)(1)(i)(E), 226.6(b)(1)(ii)(A)(1), 226.6(f)(1)(vi), 226.6(f)(3)(i), and 226.7(g)].—Current §§ 226.6(b)(6) and 226.15(b)(3) require institutions to annually submit budgets with their application. Current §§ 226.6(b)(18)(i)(C), 226.6(f)(3) and 226.7(g) require the State agency to review and approve budgets; to limit the allowable administrative costs of family day care home sponsoring organizations to the administrative costs in their approved budgets; to limit center sponsors' administrative costs to 15 percent of the meal reimbursement estimated to be earned by its sponsored centers; and to establish administrative cost limits for other institutions [*e.g.*, independent centers and sponsors of centers] as it sees fit.

We proposed to continue requiring, at proposed § 226.6(b)(1)(i)(E) and (b)(1)(ii)(A)(*1*), that both new and renewing institutions administrative budgets for State agency approval with their applications. In addition, we proposed at § 226.6(f)(1)(vi) that revised budgets be submitted for State agency review and approval by all sponsoring organizations each year, and at

proposed § 226.6(f)(3) that the budgets of independent centers be submitted as frequently as the State agency deems necessary. [**Note:** routine adjustments to annual budget projections are reviewed by State agencies for all CACFP institutions on an ongoing basis, in accordance with § 226.7(g)]. Finally, the reference to annual budgets currently found in § 226.7(g) would be deleted, since budgets for independent centers would no longer be required on an annual basis. However, all budgets, whenever submitted, would be required to demonstrate the institution's ability to manage Program funds in accordance with this part, OMB circulars, FNS Instruction 796–2, and the Department's Uniform Financial Management Requirements.

Finally, to underscore the importance of the State agency's review of the institution's budget, we also proposed to specifically state that all approved costs in the budget must be necessary, reasonable, allowable, and allocable in accordance with Department financial management regulations, OMB circulars, and the CACFP Financial Management Instruction. The audits conducted by OIG revealed State agency review of institution budgets to be a particular weakness in some States, and it is important to emphasize the purpose of the budget review and the budget amendment process in the regulatory text itself. [**Note:** several references to ''administrative budgets'' in the proposed rule have been changed to ''budgets'' in this interim rule, to clarify that State agencies must also review the operating cost budgets of independent centers, in order to ensure that the center has properly planned a food service for the number of children and meals it proposes to serve.]

We received a total of 383 comments on this provision, although 357 of these were comments that we inferred to be about the budget submission and budget review process. These 357 respondents stated, in reference to our overall changes to the application process at § 226.6, that the regulations should clarify that the authority and responsibility for managing day-to-day Program operations, including internal decision-making such as staff hiring, is retained by the sponsoring organization, unless the sponsoring organization is operating under a corrective action plan. Many of these commenters further stated that, once sponsoring organizations have demonstrated their administrative capacity, they should be expected to manage their own programs.

This comment appears to reflect opposition to the requirements for submission of information needed to assess an institution's viability, capability, and accountability through its management plan and/or budget. This raises the concern that, prior to this, the administering agency in some States was not adequately overseeing sponsor operations, especially in its review of a sponsor's management plan and budget. Additionally, we are also concerned with the commenters' apparent belief that close State agency oversight of a sponsoring organization or any institution participating in CACFP constitutes interference with the institution's management prerogatives.

As subgrantees of a Federal program administered by State agency grantees, sponsoring organizations should expect that State agencies will closely monitor their expenditure of public funds. Although many sponsoring organizations are private entities, their private status does not invalidate their responsibility for proper use of Federal funds. The State agency has every right, and the clear responsibility, to closely oversee the sponsor's use of pass-through Federal funds. How the State agency chooses to accomplish its oversight responsibility will vary, and will be a function of management style, State resources, and other factors, including the State agency's experience with CACFP institutions that have not properly managed the CACFP. There is nothing in the proposed rule, or in this interim rule's requirements pertaining to State agency review of applications, that constitutes interference with a sponsor's ability to manage its day-to-day operations. There are simply Program requirements that must be implemented at the State and local level, in order to ensure the proper delivery of Program meals to children and the proper expenditure and management of Federal funds.

Of the remaining 26 comments on this provision, 21 were from State agencies and five were from sponsors or other institutions. Seven respondents (5 State agencies and 2 sponsors/institutions) supported all of the proposals, while the remainder requested modifications to the regulatory language we proposed. These 19 suggested changes included: four commenters who believed that sponsors of affiliated centers (that is, sponsored centers which share the same legal identity as the sponsoring organization) should be required to submit a budget every three years, while sponsors of unaffiliated centers should be required to submit budgets annually, like sponsors of family day care homes; eight commenters who believed that independent centers and sponsors of affiliated centers should never be required to submit an administrative budget, because they did not receive a specific portion of the meal reimbursement to cover their administrative costs; three commenters who stated that the references to necessary costs in the regulatory language concerning budgets established an arbitrary and subjective standard, and were not consistent with Departmental and government-wide requirements that budget items be reasonable, allowable, and allocable; and four other commenters who requested that we require budgets to include projected CACFP earnings and the source of funding for Program costs over and above that covered by the CACFP reimbursement, and that we establish a percentage threshold below which an institution would not be required to file a budget amendment.

It is inappropriate to establish separate regulations for budgets submitted by sponsors of affiliated and unaffiliated centers at this time. Therefore, this rule continues to require that all sponsoring organizations (whether sponsors of homes or of affiliated or unaffiliated centers) annually submit an administrative budget. However, we agree that there was some ambiguity with regard to the requirement for renewing institutions to submit a budget, since we also proposed at § 226.6(f)(3)(i) that State agencies could require budgets from renewing independent centers (which are also institutions) as often as they saw fit. This interim rule will therefore clarify that all renewing sponsors are required to submit budgets with their renewal applications, but that State agencies are free to establish less frequent requirements for budget submission by independent centers (consistent with § 226.6(f)(3)(i)).

With regard to the reference to necessary costs, several commenters incorrectly stated that Office of Management and Budget Circulars defining cost principles for governments and nonprofit organizations do not mention necessity as a factor to be assessed in determining allowability of cost. In fact, Circular A–87, parts (C)(1)(a) and (C)(2)(a), and Circular A–122, part (A)(3)(a), both define allowable costs as costs that are necessary and reasonable. Therefore, this interim rule incorporates the regulatory language proposed at § 226.6(f)(1)(vi) requiring sponsors' budgets to include enough detailed information to allow the State agency to determine the allowability, necessity, and reasonableness of all proposed expenses.

Finally, we agree with the commenters who suggested that the requirements for the administrative

budget should explicitly refer to estimated CACFP earnings, as well as proposed expenditures, and the appropriate change has been made to §§ 226.6(b)(1)(iv)(C) and 226.6(f)(1)(vi) in this interim rule. We therefore incorporated language stating that the sponsor's administrative budget should include information on revenues derived from CACFP administrative reimbursement, as well as other sources, to illustrate how projected Program administrative expenses will be funded.

Accordingly, this interim rule incorporates the changes proposed with regard to budgets, as discussed above. Because of the further reorganization of § 226.6(b) in this interim rule, these provisions now appear at § 226.6(b)(1)(iv)(C), (b)(1)(v), and (b)(2)(i).

Current §§ 226.6(b)(7), 226.15(b)(4), and 226.16(b)(3): Licensing and Approval Information [proposed § 226.6(b)(1)(i)(F) and 226.6(f)(1)(viii)].—The current application requirements at §§ 226.6(b)(7), 226.15(b)(4), and 226.16(b)(3) require documentation of licensing or approval to be submitted each year. As previously noted, section 17(d)(2)(B) of the NSLA requires that State agencies exercising the option to take applications at other than annual intervals are nevertheless required to annually confirm that each institution is in compliance with the licensing or approval provisions of section 17(a) of the NSLA (42 U.S.C. 1766(d)(2)(B)). Therefore, the proposed rule continued to require (at proposed § 226.6(b)(1)(i)(F)) that new independent centers and facilities sponsored by new institutions submit documentation of their licensure or approval. The Department also proposed at § 226.6(f)(1)(viii) that State agencies be required to annually obtain from institutions or facilities the licensure or approval status of any institution or facility which is required to be licensed or approved.

We received two comments (one from a State agency and one from a sponsor) on these proposals. One commenter asked that we permit the use of exception lists to confirm continued licensing or approval.

We had specifically mentioned in the preamble to the proposed rule that there are a variety of ways that State agencies may comply with this requirement. In some States, the State CACFP agency and the State licensing agencies compare automated lists to find CACFP providers who are no longer licensed. In order to underscore that there are a number of acceptable means of confirming licensing or approval, we have modified the regulatory language at § 226.6(f)(1)(viii). The other commenter stated that licensing should only share information with State agencies that was relevant to the institution or facility's participation in the CACFP. This is a matter to be resolved at the State level between the agencies responsible for licensing and CACFP.

Accordingly, this interim rule incorporates the changes previously proposed at §§ 226.6(b)(1)(i)(F) and 226.6(f)(1)(viii), with the aforementioned modification to § 226.6(f)(1)(viii). In this interim rule, which further re-organizes § 226.6(b), the provision will appear at § 226.6(b)(1)(vi) for new institutions.

Current § 226.15(a) and (b)(1): Tax-exempt status information [proposed § 226.6(b)(1)(i)(G) and 226.6(f)(3)(iv)].—The current application requirement at § 226.15(b)(1) pertaining to the annual demonstration of tax-exempt status simply reiterates the requirement at § 226.15(a) that all private nonprofit institutions must annually demonstrate their tax-exempt status. As part of our reorganization of institution application requirements, we proposed to relocate this requirement at new § 226.6(f)(3), meaning that State agencies could require this information to be submitted by renewing institutions on an as needed basis, but no more frequently than annually. We received no comments on this proposed relocation and have incorporated the change in this interim rule.

We also proposed that this requirement would be retained for new sponsors at proposed § 226.6(b)(1)(i)(G), and that the periodic resubmission of such documentation should be at the State agency's discretion (§ 226.6(f)(3)(iv)). However, the interim rule published on June 27, 2002, inadvertently dropped this requirement from the application requirements at § 226.6(b).

Nine State agency commenters responded favorably to this proposed change. We are, therefore, incorporating the changes as proposed. In this interim rule, which further re-organizes § 226.6(b), the provision concerning the tax-exempt status of new institutions is re-inserted into the regulations and will appear at § 226.6(b)(1)(vii).

Current §§ 226.6(b)(8) and 226.15(b)(6): Proprietary center requirements [proposed § 226.6(b)(1)(i)(H) and 226.6(f)(3)(v)–(vi)].—Current regulations at §§ 226.6(b)(8) and 226.15(b)(6) set forth the application requirements for proprietary centers. Such centers are permitted to participate in a given month only if at least 25 percent of their licensed capacity or enrolled participants receive funding under title XX of the Social Security Act (42 U.S.C., 1397, *et seq.*) We proposed to retain the requirement that a new applicant proprietary center document its eligibility at proposed § 226.6(b)(1)(i)(H). However, no similar requirement was included for renewing institutions since, as a condition of their eligibility, such centers are required to document compliance with the 25 percent requirement each month. Therefore, we proposed to place the periodic resubmission of such documentation at revised §§ 226.6(f)(3)(v) and 226.6(f)(3)(vi), since the State agency is already receiving this information on a monthly basis as part of the claiming process.

We received a total of four comments on these proposals, two from State agencies and two from sponsors. Two of these commenters supported the proposed changes, while the two commenters who opposed the changes misunderstood their intent, believing that we had eliminated the requirement for monthly documentation of eligibility on the claim. In fact, it is because State agencies receive monthly documentation of eligibility on the claim that there is no need to address this matter in any renewal application materials; however, a State agency that wishes to require the periodic resubmission of this information may do so in accordance with § 226.6(f)(3).

Accordingly, this interim rule incorporates the proposed changes. In this interim rule, which further re-organizes § 226.6(b), the provision will appear at § 226.6(b)(1)(viii) for new institutions.

Current §§ 226.6(b)(9), 226.6(f)(5) and (f)(6), and 226.6(h): Information on commodities [proposed § 226.6(b)(1)(i)(J), 226.6(f)(3)(ii), and 226.6(h).—We proposed that the current application requirement at § 226.6(b)(9), under which institutions are to annually indicate their preference for commodities or cash-in-lieu of commodities, would be included in the requirements for new applicants at proposed § 226.6(b)(1)(i)(J) and in proposed § 226.6(f)(3)(ii) as information that State agencies could subsequently require to be submitted on an application on an as-needed basis. This would provide State agencies with the flexibility to allow institutions to submit additional information only when their initially-stated preference had changed. The requirement for annual submission of this information by institutions at current § 226.6(h) would be deleted by removing the first sentence and by

making conforming changes to the remainder of the paragraph. We also proposed that the current requirements for State agencies to annually inquire about an institution's preference for commodities or cash-in-lieu of commodities, and to annually notify all institutions of foods in plentiful supply, be moved from § 226.6(f)(5) and (f)(6) to revised § 226.6(h).

We received eight comments on these proposed changes from six State agencies. Two State agencies (four of the commenters) supported all of the proposed changes, while the other four made suggestions for changes to the proposed regulatory language. All four of these commenters suggested modifications to proposed § 226.6(h), which would require State agencies to annually provide information to all institutions on foods available in plentiful supply. These commenters either wanted the requirement eliminated, in favor of having those institutions interested in receiving surplus commodities contact the State agency, or making the notification discretionary rather than mandatory. In addition, one commenter objected to the requirement that new institutions state their preference for commodities or cash-in-lieu of commodities in their initial application, because he believed that ''most organizations are not capable of receiving commodities''.

However, current law at section 17(h)(1) of the NSLA requires State agencies to make annual determinations regarding the amount of commodities or cash in lieu of commodities needed by CACFP institutions in that State. The State agency's determination of whether to request cash in lieu of some or all of their commodity entitlement must, according to the law, base that decision on the preferences of participating institutions. Participating institutions can only make an informed decision about their commodity preferences if they know which commodities are in plentiful supply. Therefore, because of these statutory requirements, the Department is unable to eliminate the requirement for annual notification by the State agency of foods available in plentiful supply and will in this interim rule make only those changes that were proposed—to require new institutions to make an initial statement of their commodity preference in their Program application, then to permit State agencies to collect additional information from institutions on their commodity preferences on an as needed basis, whenever those preferences change.

Accordingly, this interim rule incorporates the proposed changes at § 226.6(h). In this interim rule, which further re-organizes § 226.6(b), the requirement for new institutions to indicate their preference for commodities or cash-in-lieu of commodities appears at § 226.6(b)(1)(ix).

Current § 226.6(b)(10): Advance payment information.—Section 708(f)(2) of PRWORA amended section 17(f)(4) of the NSLA (42 U.S.C. 1766(f)(4)) by making payment of advances optional at the State agency's discretion. Because a State agency could elect to issue no advance payments whatsoever, we proposed to remove all references to advances from the application requirements. Instead, we proposed to relocate the current requirement at § 226.6(b)(10) governing the institution's election to receive advance payments to § 226.6(f)(3)(vii), meaning that State agencies electing to distribute advances could require eligible institutions to state their preferences regarding advances on an ''as needed'' basis, but no more often than annually.

We received no comments on our proposal to remove this provision from § 226.6(b). Substantive comments on the statutory change are addressed in part IV(A) of this preamble, below.

Current § 226.6(f)(4): Procurement requirements [proposed § 226.6(j)]. Current § 226.6(f)(4) requires State agencies to annually determine that all meal procurements with food service management companies are in conformance with bid and contractual requirements of § 226.22. Because this requirement has nothing to do with the institution application process, we proposed to simply relocate the provision from § 226.6(f)(4) to § 226.6(j) and to delete the reference to annual determinations.

We received two comments from State agencies on this proposed change. One commenter favored the change, while the other stated that there should be greater uniformity in procurement requirements between CACFP and the National School Lunch Program. This requirement (to ensure that all food service management company contracts are competitively procured) is, in fact, uniform in both the CACFP and the NSLP, since both Programs are subject to government-wide requirements, codified in Departmental regulations at 7 CFR part 3016, that grantees and subgrantees promote competition in all procurements to the maximum extent practicable. Accordingly, we have incorporated the proposed change at § 226.6(j) of this interim rule.

Current § 226.6(f)(7) through (f)(10): Other State agency responsibilities [proposed § 226.6(f)(1)(i) through § 226.6(f)(1)(iv) and § 226.6(f)(3)(viii)].—We proposed to relocate current § 226.6(f)(7) through (f)(10), which deal with State agency responsibilities regarding information made available to pricing programs, the conduct of verification, and implementation of the two-tiered reimbursement system for family day care homes. Current § 226.6(f)(7), (f)(9), and (f)(10) were proposed to be relocated at proposed §§ 226.6(f)(1)(i) through 226.6(f)(iv), since they relate to information which the State agency must provide annually to some institutions. Current § 226.6(f)(8), which relates to the State agency's collection of verification as part of a review, was proposed to be moved to § 226.6(f)(3)(viii), and required that verification be conducted as part of State agency reviews of institutions mandated at § 226.6(l).

We received no comments on this proposed reorganization of information. Accordingly, this interim rule incorporates these changes as proposed. Due to the publication of the earlier interim rule on June 27, 2002, the latter provision is now located at § 226.6(m)(4).

B. State Agency Notification to Applicant Institutions

Prior to 1996, there were three requirements pertaining to the notification of applicant institutions in section 17(d)(1) of the NSLA. State agencies were required to: Notify the institution in writing of its approval or disapproval within 30 days; notify the institution in writing within 15 days if an incomplete application was submitted; and, if an incomplete application was submitted, provide technical assistance to help the institution complete its application.

Section 708(c) of PRWORA amended section 17(d)(1) of the NSLA by removing the requirement that State agencies provide an institution with technical assistance when the institution submitted an incomplete Program application. Then, section 107(d) of the Goodling Act amended section 17(d)(1) of the NSLA to require that a State agency notify an institution of its approval or denial within thirty days after receipt of a complete application. This gave a State agency 30 days from its initial receipt of a complete application to either approve or deny the application. The Conference Report accompanying the bill (House Report 105–786, October 6, 1998) encouraged State agencies to inform applicants as quickly as possible if an application was incomplete upon receipt. The September 12, 2000, rulemaking proposed to incorporate

these statutory changes at proposed § 226.6(b)(1)(iii).

We received a total of 22 comments on these provisions (19 from State agencies, one from a sponsor/institution, one from a State organization, and one from a commenter whose organizational affiliation could not be determined), 20 of which supported these changes. The two commenters who suggested deadlines for actions that conflicted with the NSLA were apparently not aware that we have no discretion to modify these statutory provisions. Accordingly, these changes are incorporated in this interim rule. Due to the further reorganization of § 226.6(b) in this interim rule, the provisions have been incorporated into the regulations at § 226.6(b)(3).

Part II. State Agency and Institution Review and Oversight Requirements

What Were OIG's Recommendations for Changes to the Monitoring Requirements?

As discussed above, OIG's national audit of the family day care home component of CACFP made a number of recommendations for changes to State agency and sponsoring organization monitoring requirements. Among these were recommendations to require that:

- Some or all sponsor reviews of day care homes and State agency monitoring visits to homes be unannounced;
- Routine parental contacts be made as part of State agency and sponsor monitoring of day care homes, in order to verify children's Program participation;
- Sponsors and day care providers keep more detailed information on enrollment forms, including a record of each child's normal hours of care and normal places (*i.e.*, at day care, school, or home) of receiving meals throughout the day;
- Minimum sponsor review requirements—including reconciliation of enrollment, attendance, and meal claim data—be established;
- Sponsors routinely perform certain edit checks on all meal claims submitted by their facilities; and
- Minimum standards for State agency review coverage be established.

This audit made two additional recommendations for changes to general oversight requirements that are not specifically included in the regulatory language dealing with monitoring. These include recommendations that:

- Program regulations clarify that facilities must not be reimbursed for improper claims; and that
- The Department take steps to minimize the possibility of State agencies paying claims to day care homes that were based on the provider's improper participation in the Food Stamp Program.

After the release of this national audit, OIG informally recommended that the Department:

- Address the matter of placing seriously deficient family day care homes on a National list, much as the Department currently maintains a list of seriously deficient institutions; and
- Give State agencies explicit regulatory authority to limit the transfer of family day care home providers from one sponsoring organization to another.

Finally, the ''Operation Kiddie Care'' audit made an additional recommendation related to sponsor monitoring: That the regulations prescribe a maximum number of facilities for which each sponsor monitor would have responsibility.

What Is FNS's Response to These Recommendations?

We largely concur with these formal and informal recommendations. Implementation of these recommendations will aid our ongoing efforts to improve Program management. Those audit and other informal recommendations that subsequently were statutorily mandated by ARPA have already been addressed in the interim rule published on June 27, 2002. The remaining seven recommendations are dealt with in this part of the preamble, as are several discretionary changes that we proposed with regard to sponsor review of facilities.

A. Household Contacts

What Did the OIG Audit Say About Household (Parental) Contacts?

OIG's audit of family day care home sponsoring organizations revealed that fewer than one in six sponsors sampled made parental contacts a part of their normal provider reviews. They recommended that household contacts be made a routine part of a sponsoring organization and/or State agency's review protocols in order to confirm their child's enrollment and attendance, and the specific meals routinely received by the child, at the family day care home being reviewed.

Did USDA Propose To Require That Sponsoring Organizations or State Agencies Make Household Contacts?

We believe that it would be inappropriate to mandate that household contacts be made routinely. However, we were (and remain) concerned with OIG's finding that block claiming (*i.e.*, claiming the same number and type of meals served every day) by child care facilities often goes unchallenged by sponsoring organizations. Therefore, we proposed a system requiring that both sponsoring organizations and State agencies use household contacts under certain circumstances (specifically, when either determined that facilities had submitted block claims for 10 or more consecutive days, or had claimed an inordinately high number of meals for more than one day in a claiming period) in order to detect and deter the type of fraud documented in recent audits and investigations.

How Did Commenters Respond to These Proposals?

We received more comments (515) on various aspects of our household contact proposals than we did on any other provision in the proposed rule. (Note: comments on the related topic of requiring sponsoring organizations to identify and review block claims as one type of claims edit check are discussed in part II(D), of this preamble, below). Among State agencies, institutions, and providers, there was almost universal agreement that our proposed system of household contacts was overly prescriptive and complex, and that implementation would be administratively difficult and costly for both State agencies and sponsoring organizations. Generally, most commenters also believed that the system, as proposed, would result in the conduct of far too many household contacts, requiring large administrative expenditures while not efficiently targeting or identifying those providers whose claims were most likely to be inaccurate.

More specifically, the vast majority of these commenters felt that it would be more beneficial to permit sponsoring organizations and/or State agencies to develop their own systems for making household contacts, both in terms of the findings or events that would cause a household contact to be conducted, and the procedures to be used in making household contacts. Many of these commenters mentioned that a trigger, or threshold, of 10 consecutive days of identical claims was often not indicative of an inaccurate claim. These commenters stated that, for a variety of reasons, providers in some areas regularly accept sick children in care, thus making it far more likely (especially if the home cares for a small number of children) to have identical claims for extended periods of time.

While stressing that their preference was to have sponsoring organizations or State agencies develop a household

contact policy appropriate to their particular circumstances, 349 commenters also offered specific ideas for possible modifications to the household contact system that we had proposed. Many of these comments suggested using a longer period of block claiming (generally 60 days, though a few suggested 30 or 90 days) to trigger a required household contact. Commenters also suggested changes to the requirements for the number of households to be contacted; the timing of, and the requirements for, unannounced visits when parents failed to respond or failed to corroborate the claim; and the means of notifying and contacting the parents of children in care.

In addition, 29 comments were received from 20 State agencies and nine sponsoring organizations on the proposed requirement for State agencies to conduct household contacts in the periodic sample of facilities reviewed as part of the State agency's review of a sponsor. All 29 commenters were opposed to this proposal. Commenters believed either that State agencies should never conduct household contacts, or that a State agency should only conduct household contacts under circumstances defined by the State agency.

In consideration of these concerns, and consistent with promoting greater flexibility for State agencies in their management of the Program, we have modified our proposals relating to the conduct of household contacts. Household contacts provide a means of confirming children's enrollment and attendance in care, which is critical to ensuring the integrity of the CACFP meal claim. However, the commenters have convinced us that there are many effective ways of establishing a household contact system, and that each State agency is in the best position to determine when a household contact must be made, either by the State agency or by the sponsors in that State, and the procedures for conducting household contacts. Because the development of these systems by the State agency will take time, we have delayed implementation of this provision until April 1, 2005. Therefore, this interim rule requires that:

- By April 1, 2005, each State agency develop a system that defines the circumstances under which the State agency will make, and the procedures it will use for conducting, household contacts as part of the oversight of independent centers, or in its sample reviews of sponsored facilities (§ 226.6(m)(5));
- By April 1, 2005, each State agency develop a system that defines the circumstances under which sponsors must make, and the procedures sponsors must use in conducting, household contacts as part of their review and oversight of participating facilities (§ 226.6(m)(5));
- Sponsors comply with the requirements of the household contact system established by the State agency (§ 226.16(d)(5)); and
- The State agency include in its review of sponsors an evaluation of the sponsor's implementation of this requirement (§ 226.6(m)(3)).

Although we considered the possibility of requiring State agencies to submit these household contact systems to us for prior approval, we ultimately decided that the best way for us to assess the systems was in the context of the total review of State agency operations that occurs during a management evaluation. We are taking this approach in order to provide State agencies with maximum flexibility in adapting their household contact systems to fit the particular needs of sponsors and facilities in their State. However, we will require that, by April 1, 2005, State agencies document these systems in writing and submit them to Food and Nutrition Service (FNS) regional offices. Once a State agency's household contact system is operational, we will be able to determine if it is adequate to help detect the existence of inflated facility meal counts. Based on the results of our management evaluations, we will, if necessary, provide assistance to State agencies to help ensure that their household contact systems achieve this important end. In addition, we will analyze the management evaluation findings to determine whether they provide an effective means of verifying children's attendance and whether the final rule should include further requirements related to household contacts.

As a result of the above changes, this interim rule adds a definition of ''household contact'' at § 226.2 that specifies the purpose of household contacts conducted in accordance with this broad regulatory authority, but does not specify when or how household contacts should be made. This will allow State agencies to determine when household contacts must be made (whether by the State agency itself or by its sponsors), and the procedures to be employed when making household contacts.

For the purpose of implementing the requirement that sponsoring organizations use block claiming as a mandatory edit check, we have also added a new definition of ''block claim'' to § 226.2 of the regulations (see discussion in part II(D) of the preamble, below); however, if a block claim is discovered in an edit check, this interim rule requires that an unannounced visit, rather than a household contact, be conducted.

Accordingly, this rule amends the definition of ''household contact'' at § 226.2; requires State agencies to establish systems for making household contacts at the institution and facility levels, and to review sponsors' implementation of these systems (at § 226.6(m)(5) and (m)(3), respectively), as discussed above; and requires sponsors (at § 226.16(d)(5)) to comply with the requirements of the household contact system established by the State agency.

B. Enrollment Forms

What Are the Current Regulatory Requirements Pertaining to Children's Enrollment Forms?

The CACFP is primarily designed to provide nutritious meals to children enrolled for care in licensed or approved child care facilities. Parents or guardians of children in care generally fill out an enrollment form that gives the child care provider legal permission to provide care and often includes explicit permission to obtain emergency medical care for the child. Program regulations at § 226.15(e)(2) and (e)(3) require that each institution keep a record of each child's enrollment, as well as copies of income eligibility forms used to establish a child's eligibility for free or reduced-price meals in child care centers or for tier I reimbursements in mixed tier 2 family day care homes. Section 226.16(a) specifically extends these requirements to sponsoring organizations, while §§ 226.17(b)(7), 226.18(e), 226.19(b)(8), and 226.19a(b)(8) state that child care centers, family day care homes, outside-school-hours care centers, and adult day care centers, respectively, must maintain documentation of enrollment for each Program participant. (Please note that there is no requirement for formal enrollment of children served in the at-risk or homeless components of CACFP. Further discussion of this issue is included in this part of the preamble, below.)

What Did the OIG Audit Find Regarding Enrollment Forms?

In its audit of family day care homes, OIG noted several serious problems related to the information contained on enrollment forms. The audit noted that

there is no current requirement that enrollment forms be updated on a regular basis or that they contain an indication that the child's parents had seen the form and verified its accuracy. The lack of such requirements was identified as a factor contributing to the inflation of meal counts by facilities. Without regular updates of enrollment forms by parents, providers can more readily claim meals for children no longer in care. This makes it much more difficult for sponsors and State agencies to identify inflated meal counts. OIG also noted that other useful information—such as a record of each child's normal hours of care and the place (*i.e.*, at day care, school, or home) where the child normally receives each meal service throughout the day—is not required to be on the enrollment forms. The audit recommended that enrollment forms be updated annually, be signed by parents, and include information that would assist reviewers in determining the current number of children enrolled and in attendance at the home, and the number and type(s) of meals normally received by each child while in care.

What Did the Department Propose in Response to These Recommendations?

We proposed requiring that all enrollment forms capture certain information in order to facilitate sponsoring organization reviewers' comparison of current enrollment against attendance records and meal claims. Specifically, we proposed to require that the enrollment form include the child's normal hours in care and the meals usually received in care by that child, and that the form be updated annually and signed by a parent at each update. We did not propose any changes to § 226.19a(b)(8) concerning enrollment forms for participants in adult day care centers.

What Comments Did the Department Receive on These Proposed Requirements?

We received a total of 63 comments on our proposed changes to the requirements for enrollment forms: 31 from State agency commenters in 24 different States; 23 from sponsoring organizations or other institutions; one from a national organization; one from a family day care home provider; and seven from commenters whose affiliation could not be determined.

Twenty-two (22) commenters expressed complete support for the proposed changes (eight State agency commenters from seven States, six commenters from sponsoring organizations or other institutions, one from a provider, and seven from individuals whose institutional affiliation could not be determined). In addition to expressing general support for our proposals, a number of these commenters noted that these requirements were already in place in their States or organizations, and that they constituted an important part of their system of claim reconciliation. Several sponsor commenters suggested that semi-annual enrollment updates might be even more beneficial.

Twenty-five (25) commenters were completely opposed to these proposals, including 10 State agency commenters from seven States and 15 sponsoring organization commenters. Generally, those who completely opposed these proposals did so because they felt that annual updating would entail too much cost or administrative burden for sponsoring organizations, and/or that the information on the children's normal days in care and meals received would be of little or no use. Many of these commenters feared that providers would simply instruct parents to state that their child might receive any meal service on any day so that a reviewer would have no idea as to the child's normal hours of care. Commenters also stated that parents' schedules were far too variable to be meaningfully described in terms of a normal routine.

The other 16 commenters (13 State agency commenters from 11 States, one national organization, and two sponsoring organizations) uniformly supported annual updates to the enrollment form signed by a parent, and believed that this process was important to Program integrity. However, these commenters all believed that the specification of normal days and meals received in care would not be useful, and usually cited as reasons for this belief the same arguments (variability in parent schedules or providers instructing parents to fill out the form in a particular manner) as those who opposed all of the changes. Three of the State agency commenters also stated that they believed the proposed requirements to be potentially burdensome and unnecessary for the child care center-based component of CACFP

Among the 63 comments received, seven (7) State agency commenters from four States also mentioned that their States' licensing authorities already required that certain information be captured on enrollment forms. These commenters stated that they were unable or unwilling to request that the licensing authority modify its form to capture the additional information that we had proposed on normal days in care and meals received.

What Was the Department's Intent With Respect to the Use of Enrollment Information To Reconcile Claims?

Some commenters who opposed these proposed changes seemed to believe that, because we mentioned the usefulness of this information for sponsor reviewers when conducting the newly-required 5-day claim reconciliation, we intended the reviewer to assess an overclaim whenever a meal was claimed outside of a child's normal hours of care, or to require that sponsoring organizations establish an automated system to check meal claims against enrollments on a daily basis for each child. In addition, some commenters seemed to believe that we were proposing to require a parent to modify the form every time their schedule changed.

In fact, we intended only to require that the enrollment form be updated on an annual basis, or more frequently at the discretion of the sponsor or, with Food and Nutrition Service Regional Office approval in accordance with § 226.25(b)), the State agency. We did not intend or expect this information to be reconciled perfectly on each review, nor did we intend to establish a Federal requirement that sponsoring organizations make daily comparisons between enrollment information and meals claimed. Rather, we envisioned that the expanded information on the enrollment form would primarily serve as a means of indicating potential concerns (what we have referred to in training as a ''red flag'') for sponsor reviewers during on-site reviews. If the 5-day reconciliation conducted as part of a facility review revealed that meals were regularly being claimed for children who were not enrolled and/or in attendance, sound Program management would require the reviewer to take additional steps to verify the claim's accuracy (*e.g.*, expanding the claim reconciliation beyond five days, scheduling the provider for an additional unannounced visit, and/or initiating household contacts). Similarly, the claiming of meals for children no longer enrolled will be far easier to detect in a facility review if both the sponsoring organization and the facility are required to have annually updated enrollment information on file for each child.

What Proposals Will You Implement in This Interim Rule?

Based on the above clarification, we believe it is prudent to require both annual updating of the enrollment form with parental signature and the inclusion of additional information

(normal days in care and meals received) on the enrollment form. In order to take into account the potential paperwork burden of processing large numbers of additional enrollment forms (this burden could occur for larger sponsoring organizations that currently have no system for annual updates), and to provide State agencies with time, where necessary, to coordinate with licensing authorities regarding changes to the enrollment form, we will delay full implementation of this provision until April 1, 2005. Between now and April 1, 2005, sponsoring organizations can phase in the requirement so that enrollment forms on file for all children as of April 1, 2005, are no more than 12 months old.

Given the Amount of Time That Will be Required for Sponsors To Gather This Information on an Annual Basis, Will the Department Consider This Function to be Part of the Monitoring Function for Purposes of Establishing a Monitor-Facility Ratio in Accordance With § 226.16(b)(1)?

Yes. Because the primary purpose of our proposed changes is to improve facility monitoring, and to offset some of the administrative impact of updating of the enrollment form, we will permit sponsoring organizations to include the time spent on the annual updating of enrollment forms as part of the monitoring function, for the purpose of establishing a ratio of full-time staff to sponsored facilities, as required by § 226.16(b)(1). This modifies guidance previously issued on February 21, 2003, by permitting annual renewal enrollment activities to be counted towards the sponsoring organization's monitoring hours.

Will These Requirements be Extended to Independent Child Care Centers and Adult Day Care Centers?

With regard to enrollment requirements for child care centers, both sponsored and independent child care centers are also required to implement these changes. As is the case in day care homes, annual updating of the enrollment form for children enrolled in independent centers should reduce the possibility of a center continuing to claim reimbursement for children no longer in care. Since all participants in child care centers must already have on file a current-year income eligibility form (IEF), we recommend that State agencies or sponsoring organizations consider amending the IEF to include this additional enrollment information and to ensure its annual collection. As previously mentioned, we do not believe that these new requirements need to be extended to adult day care centers, though State agencies may do so if they believe that it is appropriate.

Will These Requirements Apply to Outside-School-Hours Care Centers, At-Risk Snack Programs, or Emergency Shelters?

No. When we published the proposal, we included these changes for outside-school-hours care centers, but did not mention at-risk snack programs since they were being addressed in a separate proposed rulemaking (65 FR 60501, October 11, 2000). However, the comments we received on the proposal have convinced us that the enrollment requirement for outside-school-hours care centers is no longer appropriate, because of the drop-in nature of many of these outside-school-hours programs. A total of 49 commenters suggested that outside-school-hours care centers and/or at-risk sites be exempted from these enrollment requirements. These respondents included 31 sponsors or other institutions, one State agency, nine State or National organizations, two providers, and six commenters whose institutional affiliation could not be determined.

Similarly, given the drop-in nature of many at-risk snack programs, we have already issued guidance (January 14, 1999) that advises State agencies that there is no enrollment requirement in the at-risk component of CACFP. Please be aware that this will be addressed in a final rulemaking that will implement the at-risk snack provisions that were added to the NSLA by the Goodling Act. With regard to outside-school-hours care centers, the existing regulatory definition of outside-school-hours care center at § 226.2 and the regulations at § 226.19 have always required enrollment documentation for each child in outside-school-hours care. However, these requirements predate the enactment of the Goodling Act, which stated that at-risk programs and outside-school-hours care centers that are exempt from Federal, State, or local licensing or approval requirements could participate in CACFP based on compliance with State or local health or safety standards. Implicitly, we believe that this statutory language recognizes that both at-risk programs and outside-school-hours care centers are similar in nature, insofar as they are more likely to serve a drop-in population, as opposed to the type of regularly-attending, enrolled population normally served in day care homes and child and adult care centers. Therefore, in response to commenters' observations regarding the need for relief from enrollment requirements in these types of participating facilities, this interim rule removes references to ''enrollment'' previously found in the definition of an outside-school-hours care center at § 226.2 and in the regulations throughout § 226.19(b). Furthermore, emergency shelters participating in CACFP are also exempt from enrollment requirements (*i.e.*, there is no mention of enrollment requirements in the definition of emergency shelter at § 226.2).

What if an Outside-School-Hours Care Facility is Required by State Licensing Rules To Maintain Enrollments on File?

The rule does not exempt any institution or facility from complying with State licensing requirements. Furthermore, if State licensing rules require an outside-school-hours care center to be licensed and to regularly enroll the children in attendance, a State agency would probably wish to include a review of enrollment records in its review of the centers. This will enable a comparison of enrollment to attendance and meal claims, as further discussed in part II(C), below. However, in accordance with this rule, there is no Federal requirement that children in outside-school-hours care centers be enrolled, as there is for children in other centers or in family day care homes.

Accordingly, this rule amends § 226.15(e)(2) and (e)(3) to require that all enrollment forms be signed by a parent, be updated annually, and include information on each child's normal days and hours of care and the meals normally received in care. The rule also makes the same change in those sections of the regulations dealing with child care center and family day care home requirements at §§ 226.17(b)(7) and 226.18(e). It also adds wording to § 226.16(b)(1) to clarify that the time spent in implementing these requirements may be counted as monitoring-related time for the purpose of calculating a sponsoring organization's full-time staff devoted to monitoring. In addition, it removes references to ''enrollment'' previously found in the definition of an outside-school-hours care center at § 226.2 and in the regulations at §§ 226.15(e)(2), 226.19(b)(1), 226.19(b)(3)(i), 226.19(b)(4), 226.19(b)(5), 226.19(b)(7)(i), 226.19(b)(8)(i), 226.19(b)(8)(iv), and 226.19(b)(8)(v).

C. Standard Review Elements Required for Sponsor Review of Facilities

What Did OIG Suggest Regarding Sponsoring Organization Monitoring Requirements?

Current regulations at § 226.16(d)(4) require sponsoring organizations to review their facilities at least three times per year, but do not specify the areas to be covered during the review. OIG suggested requiring that each sponsoring organization review of a family day care home cover certain basic elements of Program management (such as recordkeeping, attendance at training, and menus) and also include a reconciliation of enrollment and attendance records with provider meal claim data. Although FNS Instruction 786–5, Rev. 1 (''Provider Claim Documentation and Reconciliation'', November 8, 1991), recommends that sponsoring organizations reconcile meal claims submitted by family day care home providers with enrollment and attendance records, it does not require that they be part of the normal review process, nor does it state that they should be utilized in reviews conducted by sponsors of centers.

What Did USDA Propose in Response to the Recommendation Concerning Standard Review Elements?

We developed separate optional prototype forms for use by sponsoring organizations in monitoring their family day care homes and sponsored child care centers, but the proposed rule did not require the use of these prototypes. However, we did propose to require that, if State agencies or sponsoring organizations developed their own review forms, the forms include, at a minimum, a review of compliance with Program requirements pertaining to licensing or approval; health, safety and sanitation; attendance at training; meal counts; meal pattern requirements; menu and meal records; and the annual updating and content of enrollment forms (if the facility is required to have enrollment forms on file, as set forth in § 226.15(e)(2) and (e)(3)).

In addition, we proposed to further amend reorganized § 226.16(d)(4)(i) to require that each review of a facility include an assessment of whether the facility has corrected problems noted on the previous review(s).

With regard to the OIG recommendation for reconciliation of meal claims with attendance and enrollment records, we proposed to amend reorganized § 226.16(d)(4)(ii) to require that each review include a thorough examination of the meal claims recorded by the facility for at least five days of operation during the current or previous claiming period. For each day examined, we proposed to require that reviewers use enrollment and attendance records (except for outside-school-hour and at-risk programs, where enrollment records are not required, as set forth in § 226.15(e)(2) and (e)(3)) to determine the number of children in care during each meal service and to compare these numbers to the numbers of breakfasts, lunches, suppers, and/or snacks claimed for that day. Based on that comparison, the reviewers would determine whether the claims were accurate. If there was a discrepancy between the number of children enrolled or in attendance on the day of review and prior claiming patterns, we proposed to require that the reviewer attempt to reconcile the difference and determine whether the establishment of an overclaim is necessary.

Finally, we also proposed two additional changes to the minimum requirements for sponsoring organizations' reviews of facilities. The first was that at least one of the sponsor's annual visits include the observation of a meal service, and the second clarified that the current minimum Federal requirement for family day care homes was that day care home providers record meal counts on a daily basis. The former proposal was discussed in the preamble but inadvertently left out of the proposed regulatory language at § 226.16(d)(4)(iii); the latter involved a minor change to the regulatory language at § 226.15(e)(4).

How Did Commenters' Respond to These Proposals?

State agency and sponsoring organization commenters were generally favorable toward most of these changes. All 19 respondents (17 State agencies and two sponsoring organizations or other instituions) who commented on the concept of including minimum review elements for sponsoring organizations in the regulations favored the idea. Ten (10) respondents made positive comments on the proposal to require the observation of a meal service at least once a year. In fact, as part of the interim rule published on June 27, 2002, current § 226.16(d)(4)(i)(B) now requires that one of the sponsor's required unannounced reviews must include an observation of a meal service.

However, three aspects of the proposed sponsor review elements received at least some negative comment: The inclusion of a health and safety element in the standard review; the clarification of the requirement for a daily meal count in family day care homes; and the proposal to include a five-day reconciliation of meal claims in each review. Each of these three areas is discussed separately below.

Review of health and safety.—A total of 397 respondents commented on the proposed inclusion of a health and safety element in the review requirements for sponsoring organizations. All but four of these commenters stated that the health and safety element should not be included in the standard sponsoring organization review requirements. Those opposed argued that health and safety issues were addressed by State or local licensing authorities; that sponsors already contacted the appropriate authorities when a health or safety problem was noted; and that any attempt by a sponsoring organization to remove a provider from CACFP, or to take other action against a provider, based on a health or safety violation, would exceed the organization's authority and open them to possible legal liability.

Section 243(c) of ARPA amended section 17(d) of the NSLA by authorizing the Department to establish standards that provide for the suspension of day care home providers' CACFP participation when there is an imminent threat to children's health or safety, or the public's health or safety. Although sponsoring organizations are not licensors and do not possess the authority to prevent a home from providing child care, they do possess the authority to determine whether the home meets the requirements for Program participation. Because of ARPA's wording, the interim rule published on June 27, 2002, required sponsoring organizations to suspend a day care home's participation when it is determined that the home has been cited by the health or licensing authority for serious violations that pose an imminent threat to children or the public (see § 226.16(l)(4)). Section 226.16(l)(4) also required that, if the sponsoring organization determines that there is an imminent threat to health or safety, it must immediately notify the appropriate State or local licensing and health authorities and take action that is consistent with these authorities' recommendations and requirements. This meets ARPA's intent to require sponsoring organizations to make common-sense determinations concerning the health and safety of children in family day care, and the provider's continued eligibility to participate in the Program, while recognizing the authority of State or local licensing or approval bodies to

determine whether the day care home will still be allowed to provide child care in that jurisdiction. In addition, the interim rule published on June 27, 2002, added to the regulations § 226.16(l)(2), which is a list of serious deficiencies for facilities, one of which is the existence of conduct or conditions that pose an imminent threat to the health or safety of children in care or the public.

Given ARPA's language concerning suspension of a day care home's participation based on an imminent threat to health or safety, and given the language at § 226.16(l)(2) and (l)(4), it is inappropriate to withdraw all reference to health and safety from this rule. However, we are also cognizant of the complex issues that could arise when a sponsoring organization takes action to remove a provider from CACFP on the basis of health or safety issues. Therefore, this rule removes the health and safety element from the list of required review elements but adds a new paragraph, § 226.16(d)(4)(viii), that requires a sponsoring organization of family day care homes to immediately contact the appropriate licensing authority when the sponsor detects conduct or conditions that pose an imminent threat to the health or safety of children in care or to the health or safety of the public. This is consistent with the regulatory language already added at § 226.16(l)(2). Since many sponsoring organizations commenting on the regulatory proposal stated that this was already their current practice, the requirement should not mark a change from current practice. Rather, the regulatory provision affirms sponsoring organizations' authority to make an assessment and clarifies sponsoring organizations' regulatory responsibility to consult with appropriate licensing officials when they find conditions or conduct that pose an imminent threat to health or safety.

Accordingly, this interim rule removes the language from § 226.16(d)(4)(i) that identified health, safety, and sanitation as a standard part of a sponsoring organization's facility review. Instead, a new paragraph, § 226.16(d)(4)(viii), has been added that describes the actions a sponsoring organization must take when it discovers conduct or conditions in a day care home that pose an imminent threat to children's health or safety, or to public health or safety.

Daily meal counts in family day care homes.—A total of 382 positive comments and 11 negative comments were received on this provision of the proposed rule. The greatest division of opinion occurred among State agency commenters, where 14 commenters agreed and 9 disagreed with the proposal. Several of these commenters (and the two sponsoring organization commenters who opposed the provision) recommended alternative language that would require day care homes to take meal counts at or near the meal service, or prior to the next meal service. Those opposed to the provision believed that meal counts needed to be taken more frequently than daily in order to ensure Program integrity and to address the type of block claiming described elsewhere in the rule. In particular, State agency opponents of the proposed language noted that group day care homes, homes providing shift care, and homes located in States with licensing standards that allow large numbers of children in family day care were examples that warranted a requirement for homes to record meal counts more frequently than daily.

We are impressed by these concerns, and are concerned that many of the commenters favoring this clarification characterized it as a prohibition on requiring homes to take meal counts more frequently than daily. While we know that large family and group day care homes and homes providing shift care are not the norm, they nevertheless exist, and our proposal was not intended to prevent a State agency from establishing additional State rules to govern these situations. Therefore, although we do not intend to modify the language pertaining to daily meal counts in family day care homes, we have added language expressly recognizing State agencies' authority to establish State requirements for more frequent meal counts in large family or group day care homes with a total of more than 12 children enrolled for care, or in day care homes that have had serious deficiency findings related to meal counts and claims. We have chosen to use this threshold primarily because we believe it reasonable to expect a provider to be able to mentally keep track of, and accurately record at the end of the day, up to that number of children in attendance on a single day. In addition, since facilities with more than 12 children in care at one time are classified as centers or group homes in most States, it seems logical to apply the requirement for time-of-service meal counts to those homes that serve more than 12 children in a single day. State agencies must not establish such requirements for homes with 12 or fewer children enrolled for care unless the home has had a serious deficiency relating to its meal counting and claiming practices. We also wish to re-emphasize, as we did in the preamble to the proposed rule, that claims for reimbursement for meals served on the day prior to the review that have not been recorded at the time of the review must not be paid.

Accordingly, this rule amends § 226.15(e)(4) to require that family day care homes take daily meal counts, but also provides State agencies with authority to establish requirements for the recording of time-of-service meal counts in family or group day care homes with a total of more than 12 children enrolled for care, or in day care homes of any size that have had serious deficiency findings related to meal counts and claims. The rule also incorporates the proposed language concerning time-of-service meal counts in centers at §§ 226.11(c)(1), 226.15(e)(4), and 226.17(b)(8).

Five-day reconciliation of claims.—As previously mentioned, we proposed to require that part of each facility review include a five-day reconciliation of meal counts against enrollment and attendance. This means that, as part of each facility review, a sponsoring organization reviewer must compare five days of meal counts from the current or previous claiming period against the facility's enrollment records and any separate daily attendance records. A total of 16 commenters responded to this provision, with 14 in favor and 2 sponsoring organizations opposed. Those who opposed the proposal believed that the addition of this requirement would be burdensome.

After the determination of a facility's compliance with meal pattern requirements, we consider the five-day reconciliation to be among the most important aspects of a facility review. Although it was not previously required, FNS Instruction 786–5, Rev. 1, had long recommended such practices. Based on abundant OIG and other review and audit findings, the September 12, 2000, rulemaking proposed to elevate the recommendation to a requirement.

Based on our conviction that on-site reconciliation during a review is a vital aspect of assuring Program integrity, this interim rule incorporates into the regulations the requirement for a five-day reconciliation as a part of all facility reviews. However, we did add regulatory language making clear that reconciliation of claims to enrollment records was not required in those types of facilities not required to keep enrollment records (*i.e.*, at-risk snack programs, outside-school-hours care centers, and emergency shelters). State agencies should also note that, to effectively instruct sponsors on how to

resolve discrepancies between enrollment/attendance and meal count/claim data, it will be necessary to develop Statewide policies and procedures that all sponsors are required to use. This will ensure consistent treatment of discrepancies across sponsors. We strongly recommend that State agencies address this issue by amending the policies and procedures they have already established and disseminated to sponsors regarding how to determine when a provider error rises to the level of a serious deficiency.

Accordingly, § 226.16(d)(4)(ii) is amended to include this requirement.

D. Meal Claim Edit Checks

What Are Edit Checks?

Edit checks are methods of comparing the information that appears on a claim for reimbursement with other information (e.g., enrollment, approved meal types) about the claiming facility's normal operations in order to help determine the claim's validity. An edit check by itself may identify erroneous claims, but more often will identify claiming patterns that serve as an indication of a possible error (i.e., the claiming pattern will be a red flag) to those reviewing the claim. These indicators should lead a reviewer to make a closer examination of the facility's claims to determine if the claims are accurate. For example, one common edit check would be to compare the total number of meals claimed by a facility to the product of the number of children enrolled at the facility, times the number of serving days in the month, times that facility's number of approved meal services. If the total number of meals exceeds the product of enrollment times serving days times approved meal services, it could be an indication that the facility has overclaimed meals in that month.

What Regulatory Requirements Now Exist To Help Ensure That the Claims Being Submitted by Facilities Accurately Reflect Their Actual Meal Service?

Section 226.10(c) of the current regulations requires all institutions to report claims information in accordance with the State agency's financial management system and in sufficient detail to justify the amount of reimbursement claimed. However, these regulations establish no specific edit check procedures that all sponsors must utilize to determine the validity of facility claims, or that all State agencies must utilize to determine the validity of institutions' claims.

What Did the Department Propose To Require With Regard to Specific Sponsoring Organization Edit Checks?

The Department proposed to amend § 226.10(c) to specify minimum requirements for the edit check process performed by sponsoring organizations, including: (1) Verifying that facilities are approved to claim the types of meals (breakfast, lunch, supper, snack) being claimed; (2) ensuring that facilities do not claim meals in excess of the maximum number they may serve in a claiming period (the common edit check mentioned in the second preceding paragraph); and (3) a means of detecting block claims (which the proposed rule defined as no daily variation in the number of meals claimed for 10 or more days). The proposal also stated that edit checks must be performed for every day meals are claimed by a facility. In addition, we proposed to incorporate similar language at §§ 226.11(b) and 226.13(b) governing consolidated claims submitted by sponsors of centers and homes, respectively.

How Did Commenters Respond to These Proposed Changes?

We received a total of 427 comments on the proposal to add specific edit checks to the CACFP regulations. In general, commenters agreed with the need for edit checks. Thirty-four (34) commenters explicitly stated their support for edit checks, while only one commenter opposed edit checks. Twelve commenters (six State agency commenters and six sponsoring organizations) explicitly endorsed the sponsor-level edit checks that we had proposed. In addition, 318 commenters stated that sponsoring organizations should be permitted to develop their own systems of edit checks, meaning that they, too, agreed with the need for some form of monthly claim system edit checks.

However, commenters overwhelmingly disagreed with the linkage in the proposed rule between the block claiming edit check and the requirement for a sponsoring organization to conduct household contacts. A total of 333 commenters wanted the block claiming edit check to be optional.

In addition, the vast majority of commenters stated that, if the Department adopted the edit checks that were proposed, they should be defined differently. A total of 345 commenters stated that the proposed rule could lead to the impression that the purpose of the edit check was a precise daily reconciliation between the claim and meals consumed by individual children. To remedy this, the commenters suggested what they referred to as a ''reasonable person standard'', and requested that the Department add explicit language clarifying that sponsoring organizations were to use such a reasonable person standard in evaluating edit checks. Most commenters specifically suggested that we add wording to clarify that the edit check was to be performed on the facility's total monthly meal claim, not on a child-by-child basis and not on a daily basis. A total of 151 commenters believed that, if the block claiming edit check were retained, it should be modified (generally by lengthening the period of time used to define a block claim from 10 days to 60 days).

What Changes Will Be Made in This Interim Rule to the Edit Check Requirements at §§ 226.10(c), 226.11(b) and 226.13(b)?

There are several. As discussed in part II(A) of this preamble, above, we have withdrawn the proposal to require sponsoring organizations to conduct household contacts as a result of the proposed block claiming edit check. In addition, we have made several changes to the wording of the regulatory language to clarify our intent that edit checks serve as a means for sponsoring organizations to assess a monthly claim's overall validity, and are not intended as a means of reconciling meals served to individual children, or to provide the more precise reconciliation of enrollment, attendance, and meal counts/claims that can be accomplished when conducting an on-site 5-day reconciliation as part of a facility review. Finally, in recognition of the time that some sponsors will need to bring their automated edit check system into compliance with these requirements, we have delayed implementation of these provisions until October 1, 2005.

Did You Retain the Block Claiming Edit Check?

Yes, although, as previously stated, it is no longer linked to a household contact. Rather, we have redefined a block claim and linked it with a different required follow-up action by the sponsoring organization.

What Is Your Revised Definition of a ''Block Claim'' in This Interim Rule, and What Consequence Now Occurs After a Block Claim Is Detected Through the Edit Check Procedure?

Although, as noted in part II(A) above, most commenters believed that children's attendance was often very regular and that 60 days of identical

claiming should constitute a block claim, we noted that other regulatory proposals (*e.g.*, the proposal to have parents list regular hours and meals received in care on the enrollment form) elicited the response that children's attendance was far too variable to be characterized in terms of a regular schedule. We still believe that claiming the same number of meals served every day for an extended period of time is an indicator of possible claiming improprieties, that sponsoring organizations must establish edit checks to detect block claims and that, once detected, they must be investigated further.

We have, therefore, added a definition to § 226.2 that defines a ''block claim'' as one in which the same number of meals is claimed for one meal type (*i.e.*, breakfast, lunch, snack, or supper) by a facility for 15 consecutive days within the claiming period (generally, one month). If a facility is providing care on weekdays only, that means the block claim trigger would be reached with three weeks of identical claims. If the facility is open on weekends as well, this will mean that the block claim trigger will be reached after just over two weeks of identical claims. Even in a small family day care home, or a home that predominantly serves children of low-income working parents, it seems quite likely that, typically, at least one child would miss a meal service at some point during a 15-day period.

This interim rule also requires a different action by a sponsoring organization when its edit check system detects a block claim. Instead of requiring the sponsoring organization to make a household contact, this rule requires the sponsor to conduct an unannounced review of the facility within 60 days of receiving the block claim from the facility. The 60-day period for conducting the follow-up unannounced review will permit sponsors of geographically dispersed rural facilities to more efficiently plan their reviews and, thus, to reduce travel costs. Furthermore, as discussed below, State agencies will be allowed to provide additional time to such sponsors on a case-by-case basis.

This interim rule also prohibits a sponsoring organization from conducting fewer than three reviews of a facility in a year in which a block claim is detected. This prohibition is discussed in greater detail in part II(F) of this preamble, below, as part of implementing the provision that permits sponsoring organizations to average the number of reviews conducted over the course of a year.

Won't the Triggering of an Unannounced Review Still Require a Great Expenditure of Effort by Sponsoring Organizations, Even in Instances in Which the Provider's Block Claim Is Repeatedly Found To Be Legitimate?

We are cognizant of the fact that the submission of identical claims by a very small family day care home provider could repeatedly trigger an unannounced visit, even though the provider's claim is totally legitimate. Therefore, this interim rule also states that, if an unannounced review is triggered by a block claim, and the review demonstrates that there is a logical explanation for the facility to regularly submit a claim that is identical for every day of a claiming period, the sponsor must document that explanation in its files, and any subsequent block claims detected during the remainder of the current fiscal year would not require the conduct of an additional unannounced visit.

That is, a sponsoring organization whose edit check system detected block claims by a provider or sponsored center would not be required to conduct more than one unannounced review of the facility that was triggered by a block claim, provided that the sponsor had documented a compelling and logical reason for the regular submission of a block claim by that facility earlier in the fiscal year, and that the documented reason for the block claim was still relevant. This provision will place an upper limit on the administrative burden on a sponsoring organization in cases where a small day care home provider is repeatedly, but legitimately, submitting a ''block claim'' as defined at § 226.2 of this rule.

This rule also allows State agencies to provide additional relief to sponsoring organizations for which the 60-day unannounced review requirement could create an inordinate administrative burden. We appreciate that a variety of factors could make it difficult, if not impossible, for a particular sponsor to conduct all of the required unannounced visits within the 60-day timeframe. In such cases, State agencies are authorized to provide a sponsor with up to 30 additional days to complete the unannounced reviews triggered by the block claim edit check.

Could This Rule Ever Lead to a Sponsor Having To Conduct More Than Three Reviews of a Facility in a Year?

Yes, but only under very rare circumstances. For example, let us say that a block claim was detected on an edit check early in the fiscal/review year, and the subsequent unannounced review led to a finding of serious deficiency (*i.e.*, the facility had no persuasive explanation for the block claim). However, if the facility successfully corrected the serious deficiency and was not terminated, a second block claim detected later in the fiscal/review year, after three reviews had been conducted, would require the conduct of a followup, unannounced review that could be the fourth total review of the facility in that year.

However, we wish to emphasize that we expect such circumstances to occur rarely. If the sponsor records a logical explanation for the block claim after an unannounced visit early in the fiscal year (*e.g.*, that a facility provides drop-in care and always fills to capacity on each day that it is open) there would be no need to conduct another (*i.e.*, a fourth) review of that facility if a block claim was detected again late in the fiscal/review year. If the sponsor had not found a logical explanation for the block claim, and believes that the facility has intentionally submitted a false claim, the sponsor must declare the provider seriously deficient, which would make moot the number of reviews to be conducted that year. Alternatively, if the sponsor is unsure that the first unjustified block claim was intentional, but a second unjustified block claim occurred during the year, it would lead to a declaration of serious deficiency and, if corrective action was not taken, termination, again rendering moot the total number of reviews to be conducted in the year.

What Other Changes to the Proposed Regulatory Language Regarding Edit Checks Are Included in This Interim Rule?

First, the language in the introductory text at § 226.10(c) was modified in several ways. The sentence in the proposed rule that referred to performing edit checks for every day meals are claimed has been removed. That sentence led some commenters to believe that we were going to require sponsors to reconcile claims against enrollment and attendance (*see* § 226.10(c)(2)) on a daily, rather than a monthly, basis. In fact, the sentence was only intended to convey that the edit checks must take into account the number of days a facility is approved to serve Program meals (*e.g.*, some facilities are approved to serve meals on weekends, while others operate on holidays). The sentence's removal from the introductory text does not alter the specific requirements set out in § 226.10(c)(1) through (c)(3).

Second, one sentence that was in the introductory text of proposed § 226.10(c), which refers to reviewing discrepancies to determine if the claim is accurate, more properly belonged in § 226.10(c)(2), because it referred specifically to the process of reconciling the number of meals claimed with enrollment and serving days. The sentence has therefore been moved to § 226.10(c)(2) in this interim rule.

Third, we have edited the regulatory text at §§ 226.11(b) and 226.13(b), which refer to the edit check responsibilities of sponsors of centers and sponsoring organizations of family day care homes, respectively. Rather than detailing the edit check responsibilities of such sponsors in each paragraph, this rule merely cross-references § 226.10(c)(1) through (c)(3), which set forth the edit check requirements that apply to all types of sponsoring organizations.

Fourth, 18 commenters specifically believed that our proposed language referring to attendance patterns promoted confusion about the purpose of the edit checks. Of course, in many cases, sponsor's would not have immediate access to their facilities' attendance records, which would limit the sponsor's ability to build information on children's attendance into a monthly edit check system. To reiterate, our intent is to require that sponsoring organizations have in place a monthly edit check system capable of detecting if a facility submits a claim that exceeds the maximum number of meals that should have been served during the claiming period (*i.e.*, claims a number of meals that exceeds the product of enrolled children times approved meal services times days of operation). We have, therefore, removed references to attendance patterns from the regulatory language in this interim rule.

Finally, this interim rule includes specific language (see **DATES** section of this preamble, above) delaying implementation of this provision until October 1, 2005, that was mentioned in the preamble to the proposed rule, but not adequately specified. As noted above, this will provide sponsoring organizations with time to update their computerized claims processing system to implement these required changes to the edit check process.

Accordingly, this rule amends §§ 226.10(c), 226.11(b), and 226.13(b) to require that, prior to submitting their consolidated monthly claim to the State agency, sponsoring organizations conduct at least three edit checks of facilities' meal claims for that period. It also amends §§ 226.10(c)(3) and 226.16(d)(4) to include the changes to unannounced review requirements for facilities that have submitted block claims in any year, as discussed above. The rule further requires that these edit checks be implemented no later than October 1, 2005.

What Did You Propose With Regard to State Agency Edit Checks of Institutions' Claims?

Management evaluations discussed earlier in the preamble revealed several instances in which State agencies did not employ edit checks when processing institutions' monthly claims. For that reason, we believe it is also necessary for State agencies to employ edit checks when processing institutions' claims. We proposed at § 226.7(k) that, at a minimum, State-level edit checks ensure that payments are made only for authorized meal types, and that the total number of meals claimed does not exceed the number of facilities claiming meals, times total enrollment, total approved meal types, and the number of approved serving days during the claiming period.

How Did Commenters Respond to These Proposals?

We received a total of 15 comments, all of which were from State agencies and their staffs. Of these, seven commenters approved of the proposed changes; two approved of them if they were monthly rather than daily requirements; two opposed them; and four opposed them while stating that other State-level edit check requirements would be acceptable.

At least some of the opposition to the proposal seemed to stem from confusion over what edit checks we were proposing to require at the State level, and how the checks were to be implemented. The two monthly claims edit checks that we proposed at § 226.7(k) were designed to ensure that: payments to institutions were made only for approved meal types; and that the number of meals reimbursed did not exceed the product of enrollment times operating days times approved meal types. We also proposed at § 226.6(l)(3) [§ 226.6(m)(4) in this interim rule] that, in the facility reviews required as part of a larger review of a sponsoring organization, State agencies conduct a reconciliation of the facilities' meal counts against enrollment and attendance, just as sponsoring organizations are required to do. We encourage State agencies to test and implement additional edit checks that would increase their ability to detect inaccurate claims during the claim review process.

We did not propose, as several commenters seemed to believe, that State-level edit checks include a day-by-day comparison of attendance, enrollment, and meal counts by type, nor did we propose that monthly edit checks done at the State level take attendance patterns into account (**Note:** as previously discussed, although we did propose that sponsoring organizations' claims edit check systems include attendance patterns as a point of comparison to meal counts, this interim rule has eliminated any reference to attendance factors or attendance patterns). The only time that we envision State agency reviewers examining daily facility records is when they are actually reviewing a facility as part of a larger review of a sponsoring organization, or when they are examining meal count records in their onsite review of an independent center.

Another commenter stated that their State agency would never have any record of the meal types (*e.g.*, breakfast, lunch, snack, supper) that sponsored facilities had been approved to serve. This comment was puzzling, insofar as the regulations at § 226.16(b) require that facilities' applications be approved by the State agency prior to participation. As part of this review of facility applications, it was our assumption that State agencies would note the meal types that facilities are approved to serve, and build into their edit check system an approximate indication of the maximum number of meals, by type, that a sponsoring organization would be expected to submit in any month. This indicator would be designed only to identify egregious errors (*e.g.*, 5 percent of the sponsor's homes are approved to serve suppers, but 20 percent of the meals on the claim are suppers). Thus, while we recognize that not all family day care homes claim Program meals each month, and that there will therefore be a normal monthly fluctuation in the number of meals being claimed by a sponsor, it should still be possible for State agencies to establish certain red flags, or indicators, in their claims processing systems that will alert them to the possibility of erroneous claims and trigger further efforts by the State agency to establish the claim's accuracy.

Accordingly, this interim rule incorporates at § 226.7(k) the monthly State agency edit checks that we had previously proposed. However, this interim rule provides State agencies with time to modify their current claims processing systems by requiring that these edit checks be implemented no later than October 1, 2005.

E. Minimum State Agency Review Requirements

What Are the Current Regulatory Requirements Pertaining to State Agency Reviews of Institutions?

The current regulations governing State agency reviews of institutions are located at § 226.6(m). This section addresses the frequency of State agency reviews and requires that they assess the institution's compliance with these regulations and with any applicable FNS or Department instructions. However, current regulations do not specify the subject areas to be examined in these reviews, nor do they mandate any specific tests to determine the validity of meal claims.

What Were OIG's Findings and Recommendations Regarding State Agency Monitoring Requirements?

OIG found that State agencies' reviews of family day care home sponsoring organizations and family day care home providers ''generally did not include sufficient tests to identify recordkeeping deficiencies and inflated meal claims, and to assess the adequacy of sponsor monitoring of [day care homes].'' We believe it is necessary to propose changes to existing review requirements in order to ensure a consistent, minimum National standard for State-level review of institutions.

What Has USDA Done in Response to These Recommendations?

We proposed that every State agency review of an institution include an assessment of certain aspects of the institution's program. In addition, we proposed that each time a State agency reviews a facility as part of its review of a sponsoring organization, the facility review must include a comparison of the facility's available enrollment and attendance records to the meal counts submitted by the facility to its sponsor. We also developed new prototype forms for State agency review of child care institutions. These forms include sections covering required Program documents on file, facility licensing or approval, meal counts, administrative costs, sponsor training and monitoring of facilities, observation of meal service, and other Program requirements. The September 2000 rule did not propose requiring State agencies to utilize these prototype forms in conducting reviews of institutions. However, we did propose to require that State agencies cover all of these areas in their reviews, and that they make any changes necessary to their State-developed review forms to ensure that the new minimum review requirements are captured on their review forms.

How Did Commenters Respond to These Proposals?

Overall, these proposals generated very little response. A total of 20 comments were received: 15 from State agencies; three from sponsoring organizations or other institutions; one from a National organization; and one from a person whose affiliation could not be determined. Of these, 17 comments were uniformly positive regarding the proposed changes, while three (3) recommended modifications and another raised a question concerning the rule's applicability to reviews of sponsors with affiliated centers.

One commenter stated that more mandatory review elements were needed. This respondent felt that reviews of sponsoring organizations should always include a review of the sponsor's disbursement of food payments to facilities and a sponsor's reconciliation of claims submitted by its sponsored facilities. These are important aspects of a State agency's oversight of a sponsoring organization, but they are already addressed in sections IX (B)(3) and IX(E)(2) of FNS Instruction 796–2, revision 3, ''Financial Management—Child and Adult Care Food Program''. State agencies may certainly choose to include these aspects of sponsor operations in their standard review protocols for institutions if they wish.

Another commenter stated that we should add to former § 226.6(l)(3) the percentage of facilities to be reviewed as part of a State agency's review of a sponsoring organization. However, the percentage of facilities to be reviewed was specified at former § 226.6(l)(5) of the proposed rule, not § 226.6(l)(3). Since publication of the proposed rule, the interim rule published on June 27, 2002, reorganized and redesignated the State agency review requirements as § 226.6(m), and although the requirements pertaining to a State agency's review of facilities—including the percentage of facilities to be reviewed—are already discussed in § 226.6(m)(6), this rule adds to § 226.6(m)(4) a cross-reference to § 226.6(m)(6) in an effort to ensure that the requirement for a specific percentage sample is underscored.

A third commenter expressed the opinion that it was not always possible to include the observation of a meal service in a State agency review. It was not clear whether the commenter believed that the review elements listed at § 226.6(l)(2) of the proposed rule (now at § 226.6(m)(3) in this interim rule) applied to facility reviews conducted by a State agency. Our intent was to specify the minimum requirements for a State agency's review of an institution, which may occur as infrequently as once every three years for an independent center. To that end, we have clarified the language of the review elements to specify that the observation of a meal service must be part of a review of an independent center. Neither the proposed rule nor this rule specify review elements for State agency reviews of sponsored facilities, except that, as previously mentioned, they must include verification of Program applications and a comparison of enrollment and attendance to meal counts submitted by facilities over a five-day period.

The final question about these provisions was how they applied to a State agency's review of a Head Start sponsor or a sponsoring organization's affiliated centers (i.e., sponsored centers that are part of the same legal entity as the sponsoring organization that enters into an agreement with the State agency). We believe that this question may also have been based on the assumption that § 226.6(m)(3) sets forth required elements for a State agency's review of sponsored facilities when, in fact, only § 226.6(m)(4) applies to the reviews of institutions conducted by a State agency.

Accordingly, this interim rule amends § 226.6(m)(3) to require that each State agency review of an institution include a review of specified review elements; amends § 226.6(m)(4) to require that each State agency review of a sponsoring organization include reviews of a sample of sponsored facilities in order to compare enrollment records, attendance records, and day-of-review meal counts observed during sponsor reviews to meal counts submitted by the facility on its monthly claim; and further amends § 226.6(m)(4) to cross-reference the verification requirements at §§ 226.23(h) and 226.23(h)(1).

F. Review Cycle for Sponsored Facilities

What Are the Current Requirements for Sponsoring Organization Review of Facilities?

The regulations at § 226.16(d)(4) establish the requirements for sponsoring organizations' reviews of their facilities, and establish different minimum requirements for facility reviews by sponsors of centers and sponsors of family day care homes.

The requirements for monitoring sponsored centers and family day care homes are similar in most respects. Both

require that: the sponsored facility be reviewed three times per year; no more than six months elapse between reviews; and new facilities be reviewed during the early stages of their operation. However, there are some differences in the current requirements for reviewing different types of sponsored facilities:

- New homes are currently required to be reviewed in their first four weeks of operation, whereas new sponsored centers are to be reviewed during their first six weeks of operation; and
- With State agency approval, sponsoring organizations of family day care homes are currently permitted to review each home an average of three times per year, meaning that they may devote a greater share of their review resources to the review of new or problem day care home providers, provided that the average number of annual visits per home is at least three. This allows family day care home sponsors more flexibility than sponsors of centers.

What Changes did USDA Propose?

We proposed to make all types of facilities subject to the same general review requirements (three reviews per year; allow no more than six calendar months between reviews; and review each new facility within its first four weeks of Program operation). We also proposed giving all sponsoring organizations (not just sponsors of family day care homes) greater flexibility in their conduct of reviews.

Specifically, we proposed that, without State agency approval, sponsoring organizations could average their facility reviews. This means that, if a sponsor administered CACFP in 300 facilities, it would still be required to conduct at least 900 reviews. Each sponsored facility would not necessarily have to be reviewed three times, but all facilities would have to have at least two unannounced reviews each year. Under our proposal, if the sponsoring organization's first two reviews in a review cycle revealed no serious problems, the sponsoring organization would have the option of not conducting a third review of that facility and instead conducting an extra review at another facility. This proposed change was intended to permit sponsoring organizations the flexibility to target their reviews to newer facilities or facilities with a history of operational problems, as they see fit, while ensuring that there is no reduction in the sponsor's overall monitoring efforts.

How Did Commenters Respond to These Proposals?

Commenters were somewhat divided in their response to this section of the proposed rule. Altogether, 430 comments were received on this portion of the proposal, with 393 expressing support for one or both of the primary proposals (uniformity in review requirements for different types of sponsored facilities and the provision of the flexibility for sponsoring organizations to conduct an average of three reviews without State agency permission). However, although sponsoring organizations were more likely than State agencies to support the averaging of reviews, a significant number of State agencies strongly supported this proposal while a small but significant number of sponsoring organizations opposed it.

Uniformity in review requirements for different types of facilities.—No negative comments were received in response to the proposal to make the review requirements identical for all types of facilities. Accordingly, that aspect of the proposed rule is incorporated in this interim rule at reorganized § 226.16(d)(4)(iii), which also includes the requirements (added to the regulation by the interim rule published on June 27, 2002) that two of the three reviews conducted be unannounced, and that one unannounced review include the observation of a meal service. In addition, readers should note that, although the requirements for facility reviews are still located at § 226.16(d)(4), the paragraphs within that section have been re-numbered to accommodate some of the changes being incorporated in this interim rule.

Averaging of reviews.—Twenty-six (26) commenters opposed the proposal to permit sponsoring organizations to conduct an average of three reviews per facility per year. Some of these commenters specifically objected to the elimination of the requirement that sponsoring organizations obtain permission for this flexibility from the State agency; other commenters (mostly sponsoring organizations) objected because they believed that providers who received their second review and knew they would not receive another review during the review cycle were more likely to become lax in their adherence to critical Program requirements.

Since publication of the proposed rule, the publication of the first interim rule on June 27, 2002, included the requirement that two reviews per facility per year be unannounced. We believe that this change will go far toward responding to the comment about providers' possible tendency to become lax after a second review. This interim rule states that a provider or sponsored center must receive two unannounced reviews during a review/fiscal year and be found to operate a compliant program (i.e., the sponsor detected no serious deficiencies, as defined in § 226.16(l)(2)) before the averaging provision can be used for that facility (i.e., before the facility is eligible to be reviewed only twice in that year). In addition, the changes made by this interim rule discussed in part II(D), above, mean that this flexibility would be unavailable to a sponsor if a particular facility submitted a block claim. Any facility that submits a block claim for any reason is not eligible to receive fewer than three reviews (at least two of which must be unannounced) in a given year. This restriction will help to ensure that those providers most in need of three or more reviews in a year will continue to receive three or more reviews. Furthermore, in accordance with the definition of an unannounced review at § 226.2, we expect that sponsoring organization monitors will not reveal anything about review schedules or review protocols to providers, meaning that providers should not know whether they are scheduled for more reviews during the remainder of the fiscal year. Finally, sponsoring organizations that are not in favor of this change are not required to implement it (i.e., they could continue to conduct three reviews of each facility each year).

Accordingly, this rule retains the proposed language on the averaging of reviews by sponsoring organizations, without State agency permission, at reorganized § 226.16(d)(4)(iv). Furthermore, in accordance with the requirements for unannounced reviews promulgated in the interim rule published on June 27, 2002, this interim rule requires that any facility reviewed only twice in a year must have had two unannounced reviews in that year without any findings of serious deficiency.

Wording of provision for averaging of reviews.—We proposed that the third review could be dropped for a particular facility when sponsoring organizations had completed two of the three required reviews without discovering serious problems. Twelve (12) commenters objected to the proposed wording and stated that it was too restrictive. Several commented, for example, that no provider would be able to meet the meal pattern standard, since minor problems

of compliance were often discovered during reviews.

Since publication of the proposed rule, the interim rule published on June 27, 2002, added language at § 226.16(l)(2) of the regulations that defines ''serious deficiencies'' for a provider or other sponsored facility. It was necessary to add this provision to the regulations in order to implement ARPA, and the list of serious deficiencies for facilities includes problems that are substantially the same as the serious problems listed in the proposed rule. However, we would hope that labeling these as serious deficiencies that could lead to a provider's termination for cause clarifies that we are not referring to minor instances of non-compliance with the meal pattern or other Program requirements. As we stressed in our training on the 2002 interim rule, we expect that, in determining what rises to the level of a serious deficiency, sponsoring organizations will exercise sound management judgment, just as we would expect State agencies to do in assessing whether an institution is seriously deficient. To underscore this point, the language describing sponsoring organizations' flexibility in this area now refers specifically to serious deficiencies as defined in § 226.16(l)(2).

If a Facility Receives On-Site Training Rather Than a Third Review, Can the Training Be Counted Towards the Sponsoring Organization's Required Number of Facility Reviews To Be Conducted for the Year?

No. This flexibility in conducting reviews was added to the regulations so that sponsoring organizations could better target reviews to those facilities most in need of them. It was not designed to allow training visits to substitute for on-site reviews.

Accordingly, this interim rule further amends § 226.16(d)(4) to:

- Make uniform the general requirements for sponsors' review of all of their child and adult care facilities, regardless of whether the facility is a home or a sponsored center;
- Permit sponsoring organizations of day care homes or centers to waive a third review at a facility if the sponsor has conducted two unannounced reviews of the facility during the review cycle without discovering a serious deficiency, as described in § 226.6(l)(2); and
- Allow sponsoring organizations of day care homes or centers to conduct an average of three reviews per facility per year across their sponsorship (*i.e.*, the third review at one facility could be deferred so that additional reviews could be conducted at a new facility or at a facility experiencing Program problems).

G. Disallowing Payment to Facilities

What Were OIG's Recommendations With Regard to Disallowing Payments to Facilities?

The OIG audit of the family day care home component of CACFP (No. 27600–6–At) found that, in some instances where a provider had submitted claims for reimbursement for meals served to absent or nonexistent children, they still received Program payment for these meals. The audit stated that, due to the wording of the current regulations at § 226.10(f), ''State agencies and sponsors may be reluctant to disallow payments and/or request repayment of total meal claims made during a period when it was determined that a [day care home] * * * claimed meals [fraudulently] for absent and/or nonexistent children.'' According to OIG, the failure of § 226.10(f) to specifically mention child and adult care facilities may have discouraged some State agencies and sponsors from withholding or recovering funds improperly paid to facilities, and OIG recommended the addition of language to § 226.10(f) to rectify this. [Please note that the OIG report erroneously identified § 226.10(f) as affecting sponsors when, in fact, it applies only to State agencies' decision not to pay all or a portion of a claim].

What Did the Department Propose?

We proposed to amend § 226.10(f) to require State agencies to deny payment of that portion of a claim identifiable with one or more facilities when audits, investigations, or other reviews reveal that the facility or facilities claimed meals for absent or nonexistent children or in other unlawful acts with respect to Program operations.

How Did Commenters Respond to These Proposals?

Altogether, 18 commenters responded to this proposal (14 State agencies, 3 sponsoring organizations, and one National organization), and all were in favor of adding facilities to § 226.10(f). Eight commenters, however, added qualifications to their support or asked that we add clarifying language to this interim rule, and some of these additional comments or concerns indicated confusion regarding the regulations' treatment of denied claims and withheld payments.

For example, four commenters stated that, in these cases, an overclaim should be assessed. However, overclaims are assessed only after a claim has been paid; this portion of the regulations deals instead with the circumstances under which it is permissible to deny payment of a claim, or a portion of a claim. Another commenter believed that the proposal compromised a State agency or sponsoring organization's ability to deny payment of a fraudulent claim, while another believed that the regulation needed to state clearly that termination for cause should be the result of the submission of false claims. We hope that the addition to the regulations of § 226.16(l) by the interim rule published on June 27, 2002, made absolutely clear that a sponsoring organization must declare seriously deficient any day care home that submits a false claim, that this is the first step in the process of terminating that provider's participation for cause, and that a sponsor must only pay the valid portion of any claim submitted by a facility. Our proposed revision of this section (§ 226.10(f)) merely clarifies a State agency's ability to disallow that portion of a sponsor's claim that is identifiable with facilities where investigations, audits, or reviews have revealed that the facility claimed meals for absent or nonexistent children or otherwise engaged in unlawful acts with respect to Program operations.

Two other comments merit special attention. These commenters stated that the language of § 226.10(f) is incomplete because it does not state that a State agency may withhold an institution's claim while it is being investigated for possible fraud, or that a sponsoring organization may do the same when handling a possibly fraudulent claim submitted by a facility. One of these commenters—apparently in reference to ARPA's prohibition on suspension of payments except under specified circumstances—stated that our proposed regulatory language would not be effective if an institution or home that submitted a fraudulent claim must continue to be paid. It is critical for us to distinguish between suspension of payments, which in all but two situations is prohibited under the NSLA, and a State agency or sponsoring organization's obligation to refuse to pay an invalid claim.

Although section 243 of ARPA and section 307 of the Grain Standards and Warehouse Improvement Act of 2000 (Pub. L. 106–472) prohibit the suspension of an institution's Program participation, including Program payments, except under certain specified conditions (the institution or home's conduct or environment poses an imminent threat to participants' health or safety or public health or

safety, or the institution knowingly submits a false or fraudulent claim), these laws did not affect the State agency's right and responsibility to deny payments to an institution when an invalid claim is submitted, or a sponsoring organization's right and responsibility to deny payments to a facility when an invalid claim is submitted. Rather, ARPA simply stated this requirement in another way: That, to the extent reasonably possible, a State agency must refuse to pay that portion of an institution's claim that is invalid, rather than suspending or withholding payment of the entire claim. Section 226.10(f) simply makes explicit that one source of information on which a State agency's decision to deny payment of a claim could be based is evidence found in audits, investigations, or reviews. The amendment to § 226.10(f) that we proposed at OIG's recommendation was intended to remove any possible perception that the State agency lacked this ability to deny payment of that portion of an institution's claim that was identified with one or more facilities where an audit or review led the State agency to conclude that the payment would be improper.

In other words, the NSLA requires that, in these cases, the State agency do more than simply freeze payments to the sponsor. Rather, it requires the continued payment of the valid portion of the claim, and the non-payment of the invalid portion of the claim. In essence, the NSLA requires that the State agency not over-react by stopping the payment of the valid portion of a claim, but also requires that it not under-react by failing to determine the reason for the erroneous claim and whether initiation of the serious deficiency process is warranted.

Accordingly, this interim rule amends § 226.10(f) as proposed.

H. Change To Audit Requirements

What Changes Did the Department Propose?

We proposed changes to the language of § 226.8(a) of the regulations, in large part to reflect changes to government-wide auditing rules.

The regulations state that, unless exempt, State- and institution-level audits must be carried out in accordance with Office of Management and Budget (OMB) Circulars A–128 and A–110 and with 7 CFR part 3015, the Department's Uniform Federal Assistance Regulations. However, audit requirements for States, local governments, and nonprofit organizations can now be found in OMB Circular A–133, ''Audits of States, Local Governments, and Non-Profit Organizations'', and the Departmental regulations at 7 CFR part 3052. These requirements apply to audits of State agencies and institutions for fiscal years beginning on or after July 1, 1996. Therefore, we proposed updating these regulatory references.

The two substantive changes to these requirements involved a change in the government-wide threshold for the conduct of audits, which was raised from $25,000 to $300,000, and the express prohibition on using Federal funds for audits not required by 7 CFR part 3052. That means that, if an institution expended less than $300,000 in total Federal resources (which includes CACFP reimbursements, the value of USDA commodities, and any other Federal funds received by the institution), it is now exempt from the Federal requirement to have an organization-wide audit or, in some cases, a program-specific audit. To address these changes to the audit requirements, we proposed two changes to §§ 226.8(b) and 226.8(c). Specifically, we proposed to revise the language at § 226.8(b), which describes the circumstances under which a State agency may make a portion of audit funding available to institutions for the conduct of organization-wide audits, to reference the new Departmental regulations governing such funds use. Also, we proposed revising the language at § 226.8(c), which describes the circumstances under which the State agency may use audit funds for program-specific audits, to clarify that the funds may also be used for agreed-upon procedures engagements (limited-scope reviews conducted by auditors), as described at 7 CFR 3052.230(b)(2).

What Rules Govern Audits for Proprietary Institutions?

The current regulations at § 226.8(a) state that proprietary (for-profit) institutions not subject to organization-wide audit requirements must be audited by the State agency at least once every two years. However, we issued guidance (dated January 18, 1991) that exempted proprietary institutions from this requirement if they received less than $25,000 per year in Federal Child Nutrition Program funds, and later issued additional guidance (dated August 13, 1998) informing State agencies that Departmental regulations at 7 CFR 3052.210(e) provide State agencies with the authority and responsibility to establish audit policy for proprietary institutions. The 1998 guidance further recommended that ''the threshold for these [proprietary] audits previously established at $25,000 should be raised, given the cost of the audits relative to the benefits''. Institutions were (and still are) also required to comply with the audit requirements of all other Federal departments or agencies from which they receive funds or other resources.

How Did Commenters Respond to These Proposals?

We received only 10 comments on these changes, seven of which were in favor. Two commenters objected to the government-wide change to the audit threshold, and believed that smaller organizations were as much in need of audits as larger ones. However, we cannot require the conduct of audits when they are not required under government-wide auditing rules. States may, of course, engage in such additional audits as they deem necessary under their own State authorities.

Two other commenters who supported the rule, plus two who did not, opposed the change in the amount of audit funding available to State agencies. Since the reduction in audit funding was mandated by the Goodling Act, it is dealt with in part IV of this preamble, below.

Accordingly, this interim rule adopts the changes to § 226.8 as proposed.

I. Income Eligibility of Family Day Care Home Providers Based on Food Stamp Participation

What Did the Operation Kiddie Care Audit Reveal Regarding Family Day Care Home Providers Claiming Income Eligibility on the Basis of Food Stamp Participation?

The Operation Kiddie Care audit uncovered problems regarding the CACFP participation of some family day care home providers whose income eligibility is based on participation in the Food Stamp Program. OIG sampled 24 providers in two States who claimed reimbursement for meals served to their own children based on their household food stamp participation. Of these providers, OIG determined that, in applying for Food Stamp benefits, 14 had not revealed, or had understated, their self-employment income from providing child care. In these cases, the provider either should have received a lower food stamp allotment, or would have been ineligible to receive food stamps at all. In some cases, this would also have prevented them from claiming Program reimbursement for meals served to their own children.

These findings were developed by OIG prior to the July 1, 1997, implementation of the two-tiered

reimbursement system for family day care home providers. Since the implementation of tiering, the fiscal consequences of underreporting child care income are potentially far greater. Providers qualify to receive Tier I rates for reimbursable meals served to all children in their care if they live in an eligible, low-income area, or if their household income is at or below 185 percent of the Federal income poverty guidelines. Providers claiming income eligibility on the basis of food stamp participation are only required to provide their name and food stamp case number to their sponsor in order to receive the higher, Tier I benefit for all children in their care. Furthermore, although sponsoring organizations are required to verify the information submitted by providers claiming Tier I eligibility based on income, there are no verification requirements, per se, for a provider claiming eligibility on the basis of food stamp participation. Therefore, if providers are improperly receiving food stamps, and if their actual household income exceeds 185 percent of the Federal income poverty guidelines, they would not be eligible to receive tier I reimbursement for CACFP meals served to all of the children in their care.

What Did FNS Propose To Address This Potential Problem?

We proposed to add, effective 6 months after issuance of an interim or final rule, a requirement that sponsoring organizations of family day care homes provide to the State agency a list of all of their sponsored providers who qualify for tier I eligibility on the basis of food stamp participation, and that they continue to supply this list to the State agency on an annual basis. Within 30 days of receipt, the State agency would be required to provide this information to the State agency responsible for the administration of the Food Stamp Program. In this way, food stamp eligibility workers would know that a specific food stamp recipient was self-employed as a CACFP day care home provider, and would be better able to discern the household's actual income. Once this information was provided to the State Food Stamp agency, they would be required, under § 273.12(c), to use the information in determining the household's food stamp eligibility.

How Did Commenters Respond to This Proposal?

Comments concerning this provision were largely negative. Of 455 comments received, 448 disapproved of our proposal, six favored it, and one commenter raised a question (''What will the Food Stamp Program do with this information?'') without stating an opinion about the proposal. Opposition came from State agencies (33 opposed, three in favor, one uncertain); sponsoring organizations and other institutions (285 opposed, two in favor); State, regional, and National groups (20 opposed, one in favor); providers (60 opposed); and those whose affiliation could not be determined (50 opposed). Of those opposed, 173 commenters cited one or more specific reasons for their opposition. The most frequent objection (mentioned by 114 commenters) was that the proposal might serve as a barrier or disincentive to participation in CACFP or the Food Stamp Program by low-income providers most in need of these programs' benefits. Many of these respondents stated that the provision of this list to food stamp eligibility workers would identify these providers as likely to be ineligible, expose their food stamp cases to exceptional scrutiny, and discourage them from applying to either program. In addition, 50 commenters believed that the proposal would impose an unwarranted burden on State agencies and sponsoring organizations, while 22 stated that this was a issue that should be addressed by the Food Stamp Program and not the CACFP. Twenty-two commenters believed that the proposed provision of information from providers' income eligibility applications violated statutorily-mandated confidentiality requirements, while 18 others cited other reasons, including a reluctance to implement a Program change on the basis of the small number of cases examined by OIG.

What Is the Department's Response to These Comments?

We regret the perception that the provision of this list may discourage legitimate participation in either the Food Stamp Program or CACFP. As a Department, we make every effort to encourage participation by eligible individuals in both programs. At the same time, we are also responsible for ensuring that those individuals receiving benefits meet the statutory requirements for eligibility.

Clearly, as the Federal department charged with administering both the CACFP and the Food Stamp Program, we have an obligation to ensure that those claiming categorical eligibility for tier I benefits in CACFP based on their food stamp participation have been accurately determined to be food stamp eligible, and that those receiving food stamps have accurately reported their household income. Self-employment income of any kind poses difficulties for those charged with making food stamp eligibility determinations and, since we are in a unique position to improve the accuracy of these determinations by sharing information across programs, we would be derelict in our responsibility as Federal administrators of both programs were we to ignore this issue.

To address this issue without referring a list of providers to the Food Stamp Program would have required that we establish separate verification procedures for providers claiming tier I eligibility based on food stamp participation. However, these procedures would likely be more burdensome to sponsoring organizations and/or State agencies, and could conflict with the NSLA's provision of tier I categorical eligibility for providers receiving food stamps. Sharing this list (which is based on information already in sponsoring organizations' possession, since they must know the basis for each home provider's tier I determination) will involve a marginal amount of added effort for sponsoring organizations and the CACFP State agency, with most of the responsibility for follow-up falling on local food stamp offices. In no way would an individual's presence on the list imply that the household's eligibility for tier I status or food stamp benefits was erroneous; however, if their food stamp case worker determined that they had failed to report income from child care when they completed their food stamp application, then the case worker would conduct a more detailed examination of the case to determine whether the provider was, in fact, eligible for food stamps. Thus, the only providers discouraged from CACFP or Food Stamp Program participation will be those who were not eligible to receive the level of benefits they had previously received.

Five commenters (including two who supported the provision) stated that the Food Stamp Program should also be required to share information with CACFP when they have utilized the information made available under this provision and re-determined a household's actual income. We will work to ensure that this sharing of information takes place whenever a provider qualifying for tier I benefits on the basis of food stamp participation is determined to have household income above 185 percent of poverty (*i.e.*, when the provider's income is determined to be ineligible for tier I benefits).

Finally, with regard to confidentiality issues, we must note that the presumption of ''confidentiality'' does not in any way protect any recipient of

Federal benefits from having their income eligibility statements subjected to closer scrutiny by appropriate State or Federal officials to review the accuracy of the program eligibility determination.

Accordingly, this rule amends § 226.6(f)(1) by adding new paragraph (f)(1)(x), requiring that State agencies annually collect from each sponsoring organization of family day care homes a list of day care home providers qualifying to receive tier I benefits on the basis of their participation in the Food Stamp Program. This new paragraph will also require State agencies to share this information with the State agency administering the food stamp program within 30 days of receipt. This provision will be effective no later than April 1, 2005.

Part III. Training and Other Operational Requirements

As discussed in the Background section of this preamble, OIG's national audit of family day care homes made recommendations for changes to the current requirements for the training of day care providers by sponsoring organizations. Specifically, OIG recommended that the CACFP regulations be strengthened to require that all participating child care providers attend a minimum number of hours in Program and child care training each year, and that minimum content requirements be established for such training. Current § 226.18 requires that the agreement between a sponsoring organization and a family day care home provider include a statement of the sponsor's responsibility to train the day care home provider; however, this provision has, in some cases, been interpreted to mean that training must be offered to day care home providers, and not that providers are actually required to attend the training. OIG also recommended that sponsor monitors receive, at a minimum, training on the same content areas provided to providers.

What Changes To Training Requirements did FNS Propose?

To address these issues, we proposed to reemphasize more strongly that the intent of the regulatory language is to require that providers attend or otherwise participate in the training that sponsors are annually required to offer. In addition, we proposed extending the requirement for mandatory attendance to all sponsored facilities, not just family day care homes. We also stated in the preamble to the proposed rule that sponsoring organizations could fulfill this regulatory requirement in a variety of ways (*e.g.*, group training, training in the provider's home, and on-line training).

What Other Operational Changes Are Addressed in This Part of the Preamble?

In addition, we proposed a number of other operational changes that had been suggested by Program administrators in recent years. These included:

- Giving State agencies the authority to place restrictions on meal service times;
- Providing State agencies with greater flexibility on payment procedures for new child care and outside-school-hours care centers;
- Stating expressly that State agencies are required to issue and enforce the provisions of all Program guidance issued by FNS;
- Stating expressly that sponsoring organizations of family day care homes may neither use temporarily nor retain any portion of providers' food reimbursement, except as specified in § 226.13(c); and
- Eliminating obsolete language with regard to the participation of adult day care centers.

Commenters' responses to these proposed changes are addressed in the preamble discussion that follows.

A. Training Requirements for Sponsored Facilities and Sponsor Monitors

What Are the Current Regulatory Requirements for Sponsor Training of Facility Staff?

The current regulations at § 226.15(e)(13) require institutions to maintain records that document:

- The date(s) and location(s) of all training sessions conducted;
- The topics covered at the session(s); and
- The names of attendees at each training session.

In addition, § 226.16(d)(2) and (d)(3) require sponsors to provide training to all sponsored child and adult care facilities in Program duties and responsibilities prior to beginning Program operations, and to provide additional training sessions not less frequently than annually afterwards. These requirements are designed to ensure that facility staff are familiar with Program requirements prior to beginning their work with CACFP, and that the facility staff participating in CACFP continue to receive additional training on a regular basis.

What Were OIG's Findings and Recommendations With Regard to Facility Training?

OIG found that compliance with these training requirements is not uniformly monitored and enforced by State agencies and institutions. Some CACFP administrators have interpreted current regulations to require that sponsoring organizations offer training to day care home providers, rather than requiring that the providers actually attend the training. In fact, § 226.18 is not entirely clear on this point; currently, the agreement between providers and sponsors must simply include a statement of the sponsor's responsibility to train the day care home's staff. OIG recommended that all participating family day care home providers receive a minimum number of hours in Program and child care training each year, and that sponsors and State agencies verify that providers receive training at least annually.

What Did the Department Propose?

We proposed at § 226.16(d)(2) to clarify that key staff (as defined by the sponsor) from all sponsored facilities are required to attend training prior to participation in the CACFP. We also proposed (at §§ 226.16(d)(3), 226.18(b)(2), 226.19(b)(7) and 226.19a(b)(11)) that key staff (as defined by the State agency) from all sponsored facilities must attend Program training at least annually thereafter. We did not believe that it was appropriate for us to establish a required annual curriculum for providers and key staff at sponsored centers, or a minimum number of annual training hours. However, we did propose that certain content on basic Program requirements be covered in the training of all sponsored child care facilities: serving meals which meet the CACFP meal patterns; explaining the Program's reimbursement system; taking accurate meal counts; submitting accurate meal claims, including an explanation of how the sponsor will review the facility's claims; and complying with recordkeeping requirements. We also proposed at § 226.15(e)(15) that sponsor monitors receive training in the same content areas as providers.

Finally, we proposed that sponsor reviews of all child care facilities include an assessment of compliance with training requirements; and that State agency reviews of sponsors always include a review of the sponsor's training (*see* proposed §§ 226.16(d)(4)(i)(D) and 226.6(1)(2)(v), respectively).

How Did Commenters Respond to the Proposal for Annual Mandatory Training and Related Proposals?

Overall, we received 49 comments dealing with one or more aspects of our training-related proposals. All 30

comments (17 from State agencies and 13 from sponsoring organizations/other institutions) that addressed the general proposal were in favor of requiring training of key facility staff and sponsor monitors. Accordingly, we have included those requirements in this interim rule at §§ 226.15(e)(14) (formerly proposed § 226.15(e)(15)), 226.16(d)(2) and (d)(3), 226.17(b)(9), 226.18(b)(2), 226.19(b)(7), and 226.19a(b)(11). A number of these commenters also stated that they supported the requirement for sponsoring organizations and State agencies to monitor compliance with this requirement as part of their reviews, and no commenters opposed the inclusion of this requirement. Therefore, these requirements were included in this interim rule at § 226.6(m)(3)(viii) [§ 226.6(l)(2)(v) in the proposed rule] for State agencies and at § 226.16(d)(4)(i)(C) for sponsoring organizations [§ 226.16(d)(4)(i)(D) in the proposed rule].

Commenters did express concern regarding the minimum content of the training, the logistics of delivering the training, and to whom the rules apply, as follows.

In-home and other forms of training.—Nineteen commenters (14 sponsors and 5 State agencies) were concerned that our use of the word ''attend'' appeared to prohibit training day care home providers in their homes. Several of these commenters suggested viable training delivery methods and settings that would meet the intent of mandatory participation, including home study, in-home training, and self-paced training. It was not our intent to limit training delivery methods or settings. We believe that effective and valuable training can be provided in a number of different settings, and in a number of different ways. Therefore, we have modified the language describing this regulatory requirement at §§ 226.15(e)(14), 226.16(d)(2) and (d)(3), 226.17(b)(9), 226.18(b)(2), 226.19(b)(7), and 226.19a(b)(11) to clarify that, while participation in training by day care home providers and key staff at sponsored centers is required, State agencies may allow institutions to develop and deliver training in the manner most responsive to the needs of their staff and facilities.

Training content.—Fourteen commenters (9 State agencies and 5 sponsors/other institutions) addressed our proposal to require that the training provided prior to Program operations, and annually thereafter, include information on basic Program information including meal patterns, meal counts, claims submission, recordkeeping, and the Program's reimbursement system. Four State agency commenters supported the proposal as worded, while nine other commenters (4 State agencies and 5 sponsors) questioned the benefit to be derived from presenting the same basic training to the same staff each year. Several of these comments stated that training appropriate for experienced staff and providers would not necessarily be appropriate for new staff and providers. One State agency commenter requested that we require a specific number of training hours per year, and another questioned how staff at affiliated centers could be meaningfully trained when they are employed by the same legal entity as the sponsor.

We anticipate that training requirements established by State agencies and the Program training provided to sponsor staff and facilities would vary according to the needs of the audience, while still meeting the minimum content requirements that we proposed. For example, training delivered to a group of experienced staff in a small child care center where all staff share duties would be different than that delivered to experienced staff in a large facility where there is division of duties, or that delivered to day care home providers. We did not intend that experienced staff (whether providers, sponsored center staff, or sponsor monitors) would have to receive the same training year after year. To clarify this point, we have retained the specific content requirements for the training of new facility staff and sponsor monitors, but have modified the wording at §§ 226.15(e)(14), 226.16(d)(2) and (d)(3), and 226.16(e)(3) by stating that the content of the training must be appropriate to the experience level and duties of the staff being trained.

With regard to specifying a minimum number of hours of annual training, we still believe that, as stated in the preamble to the proposed rule, State agencies are in the best position to develop these types of rules as appropriate. Furthermore, with respect to training the key staff at affiliated centers, we continue to believe that the general requirement for training of all key staff—whether in family or group day care homes, or in affiliated or unaffiliated sponsored centers—is a critical aspect of improving Program performance. Sponsors of affiliated centers must ensure that the staff responsible for operating their sponsored facilities is fully aware of Program requirements, since the parent (sponsoring) organization will bear the responsibility for errors committed by staff at those facilities.

Consequences of failure to participate in mandatory training.—Nine commenters (five State agencies and four sponsors/other institutions) stated that we needed to clarify the consequences to facilities that failed to participate in mandatory training, or to sponsoring organizations that failed to ensure the training of their monitors. Six of these commenters (two State agencies and four sponsors/other institutions) stated that we should clarify that sponsors are permitted to withhold all Program payments to facilities when key staff fail to participate in training. In fact, however, the use of withholding procedures (often referred to as ''stop payments'') was never advisable, and is now specifically prohibited by section 17(f)(1) of the NSLA, as explained in Program guidance issued on March 1, 2002 (''Use of ''stop payments'' in the * * * CACFP'').

The remaining three State agency commenters asked that we describe the consequences for not attending mandatory training and that we specifically address whether such facility staff or sponsors could be declared ''seriously deficient''. In fact, the interim rule issued on June 27, 2002, states at §§ 226.6(c)(2)(ii)(F) and 226.6(c)(3)(ii)(O) that sponsors that fail to train their facilities in accordance with § 226.16(d) are seriously deficient. Since a sponsor will be declared seriously deficient for failure to train facilities, it is clear that a facility that failed to participate in required training was also seriously deficient, in accordance with § 226.16(l)(2)(viii). However, to further clarify this, we have added failure to attend training as a specific serious deficiency at § 226.16(l)(2)(viii), and redesignated former § 226.16(l)(2)(viii) as § 226.16(l)(2)(ix). In addition, we have added to the sponsor-home agreement requirements at § 226.18(b)(2) specific wording that requires the home to participate in the training offered by the sponsor. This will provide notice in the agreement that, should the home fail to attend training, it would be out of compliance with the sponsor-home agreement.

Key staff.—Two commenters (one State agency and one sponsor/other institution) stated that our use of the term ''key staff'' was unclear. The sponsor commenter believed that sponsoring organizations should define key staff, while the State agency commenter believed that FNS should make this determination.

In fact, the proposed rule was inconsistent on this point. Section 226.16(d)(2), referring to training of key facility staff prior to Program operations, stated that the key staff would be defined by the sponsoring organization; § 226.16(d)(3), referring to annual training of key facility staff, said that the State agency would define key staff, as did §§ 226.17(b)(9), 226.18(b)(2), 226.19(b)(7), and 226.19a(b)(11). It was our intent that all day care home providers be trained prior to participation and annually thereafter, and that the key staff of sponsored child and adult care centers receive similar training. State agencies, not sponsors, will be most objective in determining which sponsored facility staff are required to attend training, and we have changed the wording of § 226.16(d)(2) accordingly.

B. Times of Meal Service

What Are the Current Restrictions on the Time of Meal Service?

Except for outside-school-hours care centers, current regulations do not place any limitations on the time of meal service. For outside-school-hours care centers, the regulations at § 226.19(b)(6) require that three hours elapse between the beginning of one meal service and the beginning of another, except that 4 hours must elapse between the beginning of the lunch and supper meal services when no snack is served between lunch and supper. In addition, this section of the regulations prohibits outside-school-hours care centers from beginning a supper service after 7 p.m. or ending the supper service after 8 p.m. This section of the rule also limits the duration of meal services in outside-school-hours care centers to a maximum of two hours for lunch and supper and one hour for other meal services.

Who Has Asked for Changes to These Requirements?

Some State Program administrators have periodically requested that we establish restrictions akin to those in outside-school-hours centers to meals served in other types of facilities. In the past, we were not prescriptive in other settings, having established the outside-school-hours limits due to such facilities' potential overlap and duplication of meal services already received by children in other types of child nutrition settings (primarily, child care centers or schools). However, we are concerned with recent audit and review findings that some child care facilities have abused the Program in various ways because of the lack of such meal service restrictions. In some cases, different meal services were provided with little time between them, in an attempt to maximize reimbursement; in other cases, suppers have regularly been claimed at facilities where, when reviewers are present, no children are in attendance. Some State agencies attempting to address this issue have felt hampered by the absence of Federal regulatory authority for them to establish such time limits for meal services.

What Did the Department Propose?

We proposed to give State agencies broad regulatory authority, at proposed § 226.20(k), to impose limits on the duration of meal services and the time between meal services. In States where Program reviews have uncovered patterns of abuse such as claiming of multiple meals to children in care for a brief amount of time, we believed that State agencies should have appropriate tools for eliminating such mismanagement. In these circumstances, it is appropriate for State agencies to have regulatory authority to support their attempts to limit this type of abuse.

What Comments Did the Department Receive on This Proposal?

We received 474 comments on this proposed provision. Of these, 14 were in total agreement with the proposal as written (12 State agencies and two sponsors/other institutions) while 14 sponsors or other institutions opposed it, with eight of the sponsors stating that they should be able to establish any time limits themselves, with State agency approval. Of the remaining 446 comments, all expressed partial support for the provision, but asked for modifications as follows:

- Three commenters (two State agencies and one sponsor/other institution) agreed with the provision, but asked for specific National standards on the times and duration of meal services, and the times between meal services.
- Two State agency commenters agreed with the provision, but believed that the language granting them specific authority to establish time of meal service limits should reference cultural and economic factors that should be taken into consideration.
- One sponsor commenter agreed with the provision, but believed that it should specifically refer to a prohibition on serving the same child multiple meals in a short period of time.
- A total of 191 commenters (sponsors, independent centers, providers, State and National groups, and others) agreed with the provision, but asked that the regulatory language require State agencies using this authority to establish a waiver system that referenced relevant factors that must be taken into account by the State agency.
- A total of 249 commenters (sponsors, independent centers, providers, State and National groups, and others) agreed with the provision, but asked that it include waiver language and that it specifically exempt outside-school-hours care centers from time of service requirements.

Clearly, these commenters have cited a number of reasons that a single uniform approach to times of meal service may not work. That is why, as stated in the preamble to the proposed rule, we are reluctant to establish fixed National limits. The CACFP needs to be flexible enough to accommodate children's varying needs, depending on their age, cultural traditions, socioeconomic status, participation in the Head Start Program, and even the distance that school-age children travel between child care and school. We strongly encourage State agencies to work with participating institutions to ensure that they are fully aware of the variety of factors that need to be considered in establishing time of meal service limitations in each State. However, we believe that State agencies will approach meal service limits mindful of the same concerns expressed by sponsors. It is up to each State agency to determine the necessity for waivers or another system to accommodate exceptions to a general rule. It should also be noted that nothing in this interim rule mandates that State agencies implement a specific schedule, or that they elect to establish one at all.

With regard to outside-school-hours care centers, since this rule will provide State agencies with the clear authority to establish any time of meal service requirements they believe are necessary, there is no longer a need for separate Federal restrictions on the time of meal service in outside-school-hours care centers. Therefore, this rule will eliminate the long-standing time restrictions on outside-school-hours care center meal service at § 226.19(b)(6). This change is consistent with the statutory recognition, discussed above, that both at-risk and outside-school-hours facilities often provide drop-in services that differ substantially from more structured forms of child care, and will leave to State agencies the determination as to what type of time restrictions, if any, are appropriate for the various types of facilities participating in CACFP.

Therefore, this interim rule incorporates into the regulation § 226.20(k) the same language as proposed, which clarified State agencies' authority to establish limits on the duration of meal service periods and the time between meal services. It also eliminates the time restrictions placed on meal services at outside-school-hours care centers at § 226.19(b)(6).

C. Reimbursement to Centers When Approved for Participation

What Are the Current Rules Pertaining to Reimbursement of New Centers?

Current § 226.11(a) states that State agencies provide reimbursement for meals served in centers (whether independent centers or sponsored centers) only when the institution (the independent center or the sponsor of centers) is operating under an agreement with the State agency for meal types specified in the agreement. However, § 226.11(a) also gives State agencies the option to reimburse centers for meals served in the calendar month preceding the calendar month in which the agreement is executed, provided that the center has records to document participant eligibility, the number of meals served, and that the meals met Program requirements.

Why Did the Department Propose a Change to This Provision?

State agencies have expressed concern that the current regulation's wording limits their flexibility by:

- Establishing an expectation that centers will always be paid for meals served in the calendar month preceding execution of the agreement; and
- Not specifically citing the State agency's authority to make payments only after the execution of an agreement with an institution.

We agreed with the first concern and disagreed with the second. Therefore, we proposed language that was intended to clarify that State agencies are required to begin reimbursing centers for meals when a Program agreement is signed, and when all Program requirements are being met. This was not intended to eliminate a State agency's option to reimburse a center for meals served in accordance with all Program requirements in the month prior to executing an agreement with the center. Rather, it was intended to clarify that State agencies could choose either approach—either to reimburse all centers only for meals served in accordance with all requirements after an agreement is executed, or to reimburse all centers for meals served in accordance with all requirements in the month prior to the month in which an agreement is executed.

How Did Commenters Respond to This Proposal?

We received a total of 15 comments on this provision, all from State agency staff in 10 different States. Although 11 commenters supported the proposal, several of those who supported the proposal, and all of those who disagreed with the proposal, mistakenly believed that the option to reimburse centers for meals served in the month prior to executing an agreement had been removed. In fact, our intent, as stated above, was to clarify that the State agency develop a policy based on either of these two approaches. To better clarify our intent, this interim rule modifies the last sentence of § 226.11(a).

This revised language should clarify that the State agency has two options: (1) To develop a policy that allows centers to earn reimbursement for meals served in the month preceding the month in which the agreement is executed, and to reimburse centers for those meals after an agreement has been executed; or (2) to develop a policy that permits centers to earn reimbursement only for eligible meals served on or after the date an agreement is executed. Please note that we issued guidance on May 14, 2001, that extends similar options to the reimbursement of day care homes for meals.

Accordingly, this interim rule modifies the language at § 226.11(a) pertaining to the reimbursement of meals served in centers.

D. Regulations and Guidance

What Did the Department Propose?

Section 226.6(l) makes State agencies responsible for monitoring institutions' compliance with Program regulations ''and with any applicable instructions of FNS and the Department.'' These instructions interpret existing rules by clarification or explanation and do not impose new substantive requirements. Although this requirement and case law have demonstrated that State agencies have the authority and the responsibility to apply Federal guidance that interprets the regulations and the law, we proposed regulatory language at §§ 226.6(l) and 226.15(m) that underscored this fact. Comparable regulatory language already exists in other programs, such as the Summer Food Service Program (*see* 7 CFR 225.15(a)). The governing statute for CACFP may be found at *http://www.fns.usda.gov/cnd/Governance/nslp-legislation.htm;* Program regulations may be found at *http://www.fns.usda.gov/cnd/Care/Regs-Policy/new226.pdf* and Program guidance may be found at *http://www.fns.usda.gov/cnd/Care/Regs-Policy/policy.htm* or by contacting the State agency or the Food and Nutrition Service.

How Did Commenters Respond to This Proposal?

A total of 21 commenters responded, with 17 in support of the proposal and four in opposition. Of the 17 commenters in favor (15 State agencies and two sponsors/other institutions), three requested that we add language clarifying that State agencies have authority to impose additional requirements, provided that they are not in conflict with the Federal regulations. This wording is unnecessary, however, since the proposed changes referred to the State's authority to monitor compliance with regulations, instructions, and handbooks issued by the State agency which are consistent with the CACFP regulations. In addition, existing § 226.25(b) permits State agencies to add requirements for participation, provided that they are consistent with the Federal regulations and are approved by the FNS regional office.

The four commenters who disagreed (two State agencies and two sponsors/other institutions) stated that any form of guidance not promulgated through the rulemaking process was not enforceable. This is precisely the misconception that our proposed regulatory language was meant to address. In fact, the Administrative Procedures Act (5 U.S.C. 553) specifically exempts ''interpretative rules'' and ''general statements of policy'' from publication in the **Federal Register**. State agencies issuing handbooks and other guidance must ensure that they comply with both Federal and State law governing such publications, and that they do not conflict with the intent of any Federal Program or other requirement. Furthermore, the State's procedural rules must not diminish, contradict, or impose additional eligibility requirements for institutions that would otherwise be eligible under Federal requirements. For example, based on identified problems, a State agency could impose additional monitoring requirements, but could not require a new independent center to post a performance bond as a condition of eligibility.

By stipulating that institutions must comply with instructions, guidance, and handbooks issued in accordance with

regulations, we are emphasizing the authority of the Department and State agencies to issue such rules and statements of policy through the publication of handbooks and other forms of instruction. We have changed the language of the proposed rules to clarify this point.

Accordingly, this interim rule implements the changes as proposed. As a result of changes promulgated in the interim rule published on June 27, 2002, these provisions appear at §§ 226.6(m)(3)(iv) [formerly the introductory paragraph of proposed § 226.6(l)(2)] and 226.15(m).

E. Sponsor Disbursement of Food Payments to Providers

What Are the Rules Governing Sponsors' Disbursement of Meal Service Payments to Family Day Care Homes?

The regulations at §§ 226.13(c) and 226.18(b)(7) state that sponsoring organizations of family day care homes must disburse the full amount of meal service earnings to providers except that, with the day care home provider's prior written consent, § 226.18(b)(7) stipulates that the sponsor may deduct the costs of providing meals or foodstuffs to the provider. In recent years, we have been asked whether the regulations would permit sponsors:

- To temporarily retain some portion of the providers' meal service payments; or
- With or without prior written consent, to subtract the costs of other goods or services (*e.g.,* liability insurance premiums, toys, or educational materials) provided to the family day care provider; or
- To withhold part or all of a provider's reimbursement if the provider fails to attend training, or otherwise violates regulatory provisions.

The intent of the current regulations is to prohibit any retention of meal service payments received by the family day care home sponsoring organization from the State agency, except in the single specific instance described in the regulations (there is a written agreement for the provision of meals or foodstuffs by the sponsor to the provider) or in the more general circumstance of a provider having submitted a claim that is erroneous or invalid. All of these circumstances are also set forth in FNS Instruction 796–2, revision 3, section IX(B)(3)(c).

We are well aware that sponsors often sell other goods or services to family day care home providers, including providers they do not sponsor. However, there is no reason for the government to facilitate transactions through the retention of food service payments provided under the CACFP. Such practices are not intended by section 17 of the NSLA, and we intend there to be no exceptions save that mentioned in the current rule. Therefore, we proposed to amend § 226.18(b)(7) to further clarify the limitations on sponsoring organizations' temporary or permanent retention of meal service payments, except when it is expressly permitted by the regulation.

What Comments Did You Receive on These Proposed Changes?

We received a total of 73 comments on this proposed change, 11 from State agencies and 62 from sponsoring organizations or other institutions. All commenters supported the change, though many of the sponsor/institution comments requested that we add language permitting sponsors to withhold claims without State agency permission, either due to other violations of regulations, such as failure to attend required training, or due to the day care home's submission of an invalid claim.

As discussed above (*see* part II(G) of this preamble, above), as a result of ARPA, suspension of payments (*i.e.,* cutting off all payments to a provider) is not permitted except when the provider is found to have created an imminent threat to public health or safety. Furthermore, the NSLA does not permit the withholding of payments to a provider based on the provider's failure to attend training. Instead, the sponsor's recourse in such a case is to give the provider time to come into compliance, then to declare the provider seriously deficient if the provider remains in noncompliance.

However, we did not intend to limit the sponsor's ability to deny payments to a provider who has submitted an invalid claim. We agree with commenters that our proposed language stating that the denial of invalid claims could only occur with the State agency's prior consent presents an unnecessary impediment to sponsors' effective management of the Program, and that language has been removed from this interim rule.

Accordingly, this interim rule incorporates the language proposed at § 226.18(b)(7), with the change discussed above.

F. Technical Changes

We received no negative comments regarding our proposal to eliminate obsolete adult day care provisions at § 226.25(g), nor did we receive any recommendations for clarification. Therefore, we will adopt our proposed regulatory language in this interim rule.

We also added a second technical change to this interim rule. Section 226.6(o) was amended to reflect the changes to serious deficiency and suspension procedures mandated by the Agricultural Risk Protection Act of 2000.

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

In addition to the discretionary changes discussed in parts I-III of this preamble, the proposed rule also included a number of non-discretionary changes as well. Non-discretionary changes are those that are specifically mandated by law, and the Department, therefore, must include these provisions in the Program regulations. Although the Department could have issued these non-discretionary changes in an interim or a final rule, without first soliciting public comment, we included these provisions in the proposal, both as a matter of convenience and as a means of gathering comment on the manner in which we were proposing to implement several of these provisions.

A. Issuance of Advances to Institutions Participating in CACFP

What Did You Propose With Respect to Advances?

As discussed in part I(A) of the preamble, above, we proposed to implement a statutory change relating to advances that was promulgated in section 708(f)(2) of PRWORA. Prior to the PRWORA's passage, State agencies were required to issue advance payments for CACFP to institutions that requested them. However, due to findings that advances were being abused in some cases, the NSLA was amended by PRWORA to make the issuance of advances optional. As we explained in the preamble to the proposed rule, 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 would it be necessary to offer an appeal of the State agency's decision.

How Did Commenters Respond to the Proposal?

We received 12 comments on this provision, 11 of which were favorable. The commenter who objected believed that State agencies should not be provided with this latitude, and that

institutions with successful Program performance should be guaranteed an advance if they apply for one. However, as previously noted, the NSLA now makes advances optional at the State agency's discretion.

Of the commenters who agreed with the proposal (six State agencies, four sponsors, and one State organization), seven requested that additional language be included in the regulations. Five commenters asked that the regulations state that State agencies could also elect only to make available operating advances or administrative advances. Another commenter suggested that the regulations state specifically that the State agency may refuse to issue any advances whatsoever. We have already issued guidance (dated January 27, 1997) that clarified that State agencies had a variety of options in implementing this provision. It would certainly be possible for a State agency to issue operating advances only, administrative advances only, or no advances at all. Any of these options would prevent a State agency from having to offer an appeal to an institution requesting an advance that was not available to similar institutions. We also have issued periodic guidance on the matter of collecting advances.

What is at issue is whether it would be advantageous for any or all of this information to be codified in the Program regulations. In general, we prefer to address detailed procedural aspects of implementation in interpretive guidance, rather than in the regulations, as previously discussed. FNS also has training and regional office dialogue with State agencies as methods for addressing such inquiries and issues. For that reason, we are implementing this regulatory change as proposed at § 226.10(a).

B. Change to Method of Rounding Meal Rates in Centers

What Did the Department Propose?

Section 704(b)(1) of PRWORA amended section 11(a)(3)(B) of the NSLA by changing the method to be used by the Department in making annual adjustments to the national average payment rate for paid meals served in the NSLP and SBP. This change also affected the method of rounding used to calculate the annual adjustment to the rate for paid meals served in child care centers and adult day care centers participating in the CACFP because, under sections 17(c)(1) through (c)(3) and 17(o)(3) of the NSLA, these rates are linked to the rates and rounding methods established in section 11(a)(3)(B). Later, section 103(b) of the Goodling Act extended the same rounding procedure to the free and reduced-price meal rates in NSLP, SBP, and the center-based component of CACFP, effective July 1, 1999. Therefore, we proposed to modify the language at § 226.4(g)(2) of the regulations to reflect this change. In addition, we proposed to change the word ''supplements'' to ''meals'' at § 226.4(g)(2) of the regulations since this paragraph is clearly intended to describe the method of adjusting and rounding the rates for all meals (not just snacks/supplements) served in child and adult day care centers.

How Did Commenters Respond?

We received a total of three comments on this provision, all from State agencies. All approved of the change, but one commenter questioned why we were not making a similar change to the method of rounding meals served in day care homes. In fact, we have made this change at § 226.4(g)(1) as a statutorily-mandated part of the implementation of the two-tiered system of reimbursement for family day care homes (62 FR 889, January 7, 1997). Therefore, we will adopt in the provision as proposed in this interim rule at § 226.4(g)(2).

C. Elimination of Aid to Families With Dependent Children (AFDC) Program

What Did You Propose, and How Did Commenters Respond?

As a result of PRWORA, the Federal AFDC Program was block granted and its name was changed to Temporary Assistance for Needy Families (TANF). This change requires us to change all references to ''AFDC'' and ''AFDC assistance units'' in the rule and to replace them with ''TANF'' and ''TANF recipient.''

We received three comments in favor of this mandatory change, and this interim rule will make this change to our regulatory language as proposed.

D. State Agency Outreach Requirements

What Did the Department Propose?

Section 708(a) of PRWORA amended the statutory purpose statement for CACFP by amending section 17(a) of the NSLA. Previously, the law stated that the purpose of CACFP was to assist States to initiate, maintain, and expand nonprofit food service programs for children in child care. Section 708(a) deleted the words ''and expand'' from this sentence. In addition, section 708(h) of PRWORA revised section 17(k) of the NSLA in its entirety. Previously, this section of the NSLA had required State agencies to facilitate expansion and to annually notify each nonparticipating institution of the Program's availability, the requirements for participation, and the procedures for application. As a result of this change, the NSLA now requires State agencies to provide sufficient training, technical assistance, and monitoring of the CACFP.

Did This Change Eliminate Outreach From the CACFP?

No. State agency outreach is still an allowable and desirable Program activity. Although PRWORA removed two specific requirements for State agency outreach, it also underscored the State agency's responsibility to promote Program expansion in low-income and rural areas. Prior to PRWORA, the NSLA had been amended to make additional funds available to sponsoring organizations of day care homes for expansion into rural or low-income areas. A later amendment permitted day care home sponsors to use their administrative funds to defray the licensing-related costs of non-participating low-income day care home providers. The PRWORA underscored Congress' commitment to these provisions by mandating that we publish interim regulations implementing these changes and giving them the force of law, which was done in 1998 (63 FR 9721, February 26, 1998). Thus, although the specific requirement for State agencies to notify non-participating institutions was removed, the law continues to promote program expansion among rural and low-income family day care home providers.

Based on these congressional actions, we proposed to modify two paragraphs within § 226.6, which sets forth State agency responsibilities. We proposed to amend § 226.6(a) to require that State agencies continue to commit sufficient resources to facilitate Program expansion in low-income and rural areas, and proposed to amend § 226.6(g) to eliminate the language requiring that State agencies take specific actions to facilitate expansion, while retaining the broader requirement that State agencies take action to expand the availability of Program benefits Statewide, and especially in low-income and rural areas. We believe that these changes meet congressional intent to eliminate the broad requirement that State agencies expand the Program, and to substitute a requirement for targeted expansion in low-income and rural areas.

How Did Commenters Respond to These Proposals?

We received seven comments on this provision—four from sponsors or other

institutions, two from State agencies, and one from a State organization. All commenters favored this change, but five of the seven commenters believed that we should also include outreach to Tier II homes as a State agency requirement. These commenters stated that the recruitment and retention of Tier II homes had become much more difficult after the introduction of the two-tiered reimbursement system in family day care homes.

Although we are aware that many sponsors have expanded their efforts to recruit and retain Tier II homes in recent years, we do not believe that the wording of the NSLA would support our requiring State agencies to engage in these efforts. Because of the NSLA's continued emphasis on Program expansion in low-income and rural areas, a requirement for State agency action to facilitate growth in Tier II areas is not warranted. State agencies could elect to use State administrative resources in support of other expansion efforts; however, they are only required to make such efforts in low-income and rural areas. Therefore, we will adopt in this interim rule the language we proposed at §§ 226.6(a) and 226.6(g).

E. Prohibition on Payment of Incentive Bonuses for Recruitment of Family Day Care Homes

Why Did USDA Propose this Change?

Section 708(b) of PRWORA amended section 17(a)(6)(D) of the NSLA by prohibiting any family day care home sponsoring organization which employs more than one person from basing payment to employees on the number of family day care homes recruited. These terms were not defined by Congress, permitting us to broadly construe the terms ''employee'' and ''payment''. For example, sponsoring organizations often pay individuals (including family day care home providers whom they sponsor for CACFP) to perform specific program functions, such as training, monitoring, or recruitment through a contractual arrangement. Although that person is not a full-time employee of the family day care home sponsoring organization, we nevertheless believe that they are covered by this prohibition. We are also aware that sponsor employees can be paid in a variety of ways (*e.g.*, salaries, hourly wages, or on a piece-work basis). It is our position that Congress intended to prohibit any type of payments (including bonuses, contract incentives, free trips, or any other perquisite or gratuity) under any compensation system if the payment is based on recruitment activities performed by any full-time or part-time employee, contractor, or family day care home provider.

Can Sponsors Still Use Administrative Funds for Recruitment?

Yes. The recruitment of family day care home providers to participate in CACFP is still an allowable expense, as long as (as noted in the preamble to the interim rule published on June 27, 2002) the provider is not currently participating in CACFP. In fact, as noted in the previous part of this preamble, the NSLA continues to encourage recruitment of non-participating providers in low-income and rural areas. This means that family day care home sponsors are permitted to pay employees or contractors to perform recruitment functions. However, the person being paid cannot be reimbursed solely on the basis of the number of homes recruited. Similarly, including the number of homes recruited as an evaluation factor when measuring an employee or contractor's performance is permissible, whereas providing a bonus or award for recruiting a certain number of homes would not be permissible. Therefore, we proposed to amend the regulations at § 226.15 by adding a new paragraph, (g), which prohibits sponsoring organizations of family day care homes from making payments to employees or contractors solely on the basis of the number of family day care homes recruited.

What Comments Did You Receive on This Proposal?

We received a total of eight comments (six from sponsors or other institutions, two from State agencies) on this provision. Seven were positive and one was opposed to the change; however, the commenter who opposed the change was a sponsor who mistakenly believed that the proposal would prevent her from paying employees based on the number of homes they monitor. In fact, all systems of compensation are allowable unless they are based on the number of homes recruited. Another commenter asked whether this provision would prohibit a sponsor from paying a provider a bonus for recruiting other providers. If the sole condition for receiving the bonus was the number of day care homes that began participating with the sponsor, the bonus would not be permitted.

Accordingly, this interim rule adopts the language at § 226.15(g) as proposed, and redesignates § 226.15(g) through (k) as § 226.15(h) through (l), respectively.

F. Pre-Approval Visits by State Agencies to Private Institutions

What Did You Propose to Change Regarding State Agency Pre-Approval Visits to New Institutions?

Section 107(c) of the Goodling Act amended section 17(d) of the NSLA (42 U.S.C. 1766(d)) to require State agencies to visit private institutions (both non-profit and for-profit) applying for the first time prior to their approval to participate in CACFP.

We believe that the change made to § 226.6(m)(2) (formerly § 226.6(l)(2) in the interim rule published on June 27, 2002) which requires State agencies to target for more frequent reviews those institutions whose prior review included a finding of serious deficiency, goes far towards fulfilling the second statutory requirement. With regard to the requirement for pre-approval visits to private institutions, we believe that Congress intended to exclude from this requirement both public institutions and institutions which are adult day care centers, and to focus additional State agency oversight on child care institutions, and especially on sponsors. The Conference Report language (Conf. Report 105–786, October 6, 1998) focuses throughout on the Program management problems documented in OIG audits. These audits have been confined to family child care homes and/or child care centers because these organizations account for such a large share of Program reimbursements.

We recognized that requiring State agencies to conduct a pre-approval visit of each new independent center, especially in geographically large and rural States, could result in delays in approving such centers. Therefore, we addressed this issue in Program guidance issued on July 14, 1999. That guidance set forth various ways in which the pre-approval requirement might be met for independent centers (including obtaining information gathered by the State licensing agency in its previous visit(s) to the center), and described certain circumstances under which we would be willing to entertain State agency requests to waive the pre-approval requirement for one or more independent centers. Thus, the guidance provides State agencies with options for meeting the legal requirement with respect to independent centers, but ensures that a pre-approval visit to sponsoring organizations by the State agency will always occur.

What Comments Did You Receive on This Provision?

We received four comments on this provision, all from State agencies. One commenter suggested that we consider modifying the rule to require visits to institutions that are adult day care centers, and another suggested the addition of both adult day care institutions and publicly-administered child care institutions. A third commenter noted the administrative burden on State agencies in implementing this provision.

While there could be some benefit to extending the scope of this requirement, the Goodling Act clearly stated that the requirement applies to private child care institutions. State agencies may, of course, choose to conduct pre-approval visits to adult day care or public child care institutions, provided that approval or denial is not delayed due to the State agency's inability to perform the pre-approval visit in a timely fashion. Therefore, this interim rule implements our regulatory language as proposed. Due to the further re-organization of § 226.6(b) in this interim rule, the provision will appear in the introductory paragraph of § 226.6(b)(1).

G. Provision of Information on the WIC Program

Why Did You Propose To Require the Distribution of Information on the WIC Program?

Section 107(i) of the Goodling Act required us to provide State agencies with information concerning the Special Supplemental Nutrition Program for Women, Infants and Children (WIC) Program. The Goodling Act also required State agencies to ensure that each participating facility and independent child care center (other than outside-school-hours care centers) receive materials that explain WIC's importance, its income eligibility guidelines, and how to obtain benefits. In addition, State agencies were required to provide these facilities and institutions with periodic updates of this information and to ensure that the parents of enrolled children receive this information.

On April 14, 1999, we provided the required information on WIC to each State agency administering the CACFP. We proposed to amend § 226.6(q) to require that State agencies distribute this information to each child care institution participating in the Program, and § 226.15(n) to require that the institution make this information available to each sponsored facility (except sponsored outside-school-hours care centers), and to ensure that institutions and/or facilities make this information available to the households of participating children.

How Did Commenters Respond to These Proposals?

We received four comments on these proposals, three from State agencies and one from a sponsor. Two comments (one from a State agency and the sponsor comment) were favorable, and two expressed opposition to the provision. One of these opposed the administrative cost of distributing the information, and felt that it should be borne by the WIC Program; another stated that parents eligible for WIC were already well aware of the Program. However, distribution of this information is required by the NSLA; therefore, we will adopt our regulatory language as proposed, at §§ 226.6(q) and 226.15(n).

H. Audit Funding for State Agencies

What Change Did You Propose To 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 made available to State agencies. Prior to this change, State agencies could receive up to two percent of Program expenditures during the preceding fiscal year to conduct Program audits. This was changed to one and one-half percent of Program expenditures in the previous fiscal year, beginning in fiscal year 1999. In addition, in order to meet mandatory ten-year budget targets, the Goodling Act also mandated a further reduction (to one percent) in fiscal years 2005 through 2007, but it was unclear whether the reduction for fiscal years 2005–2007 would occur. Therefore, we proposed to amend § 226.4(h) by removing the words ''2 percent'' and substituting in their place the words ''1.5 percent'.

However, it now appears that the reduction to 1 percent funding will occur in fiscal years 2005–2007. Therefore, this interim rule incorporates language at § 226.4(h) that refers to the 1 percent funding level for fiscal years 2005–2007.

How Did Commenters Respond?

We received only one comment, from a State agency, on this provision. That commenter observed that every effort must be made to safeguard 1.5 percent audit funds during fiscal years 2005–2007. However, because the reduction to 1 percent is likely to occur, as noted above, the language of § 226.4(h) has been amended to reflect the lower levels of funding for fiscal years 2005–2007.

I. Elimination of Fourth Meal in Child Care Centers

Section 708(d) of PRWORA amended section 17(f)(2)(B) of the NSLA by eliminating child care centers' ability to claim reimbursement for four meals (either two meals and two snacks or three meals and one snack) served to a single child in a day. Prior to this change, child care centers and outside-school-hours care centers had been permitted to claim reimbursement for a fourth meal served to a child who had been maintained in care for eight or more hours on that day.

We neglected to include this change in our proposed rule. However, since it is non-discretionary, we have included it in this interim rule for implementation in keeping with the congressional mandate.

Accordingly, this rule amends §§ 226.15(e)(5), 226.17(b)(3), and 226.19(b)(5) to eliminate outdated references to a fourth meal.

Part V. Procedural Matters

Executive Order 12866

This interim rule has been determined to be significant and was reviewed by the Office of Management and Budget under Executive Order 12866.

Regulatory Flexibility Act

This interim rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601–612). Eric M. Bost, Under Secretary for Food, Nutrition, and Consumer Services, has 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 18,000 institutions (sponsoring organizations and independent centers) in over 210,000 facilities. The vast majority of institutions and facilities participating in CACFP are small in size. Nevertheless, the changes implemented in this interim rule will not have a significant economic impact, except where improved monitoring procedures lead State agencies to terminate institutions' agreements or sponsoring organizations terminate their facilities' agreements. In short, there will be little or no adverse impact on those entities administering the CACFP in accordance with Program requirements, since most of these changes were proposed in order to improve compliance with existing regulations and in accordance with statutory changes to Program operations.

This rule will primarily affect the procedures used by State agencies in reviewing institutions' applications to

participate in CACFP and in monitoring participating institutions' performance. This rule will also affect participating institutions' operation of the CACFP. These changes will not, in the aggregate, have a significant economic impact on small entities.

Regulatory Impact Analysis

This rule implements a number of changes to existing Program regulations, as proposed in our rulemaking of September 12, 2000 (65 FR 55101), and as modified in this rule as a result of public comment. 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 and State and FNS reviews, there is no statistically representative information available on CACFP integrity. OIG reports have focused on purposely-selected institutions and facilities, and 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. While the OIG and other reports clearly indicate that there are weaknesses in parts of the Program regulations, and that there have been significant weaknesses in oversight by some State agencies and sponsoring organizations, none of these reports estimate the prevalence or magnitude of USDA fraud, abuse, or mismanagement.

This lack of information makes it difficult for us to estimate the amount of CACFP reimbursement lost due to fraud, abuse, or mismanagement. For that reason, the fiscal impact of these provisions cannot be estimated.

Executive Order 12372

This Program is listed in the Catalog of Federal Domestic Assistance under No. 10.558 and is subject to the provisions of Executive Order 12372, which requires intergovernmental consultation with State and local officials (part 3015, Subpart V, of this title, and final rule related notice published in 48 FR 29114, June 24, 1983, and 49 FR 22676, May 31, 1984).

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 interim rule, we received input from State and local agencies at various times. 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 helps to influence our discretionary rulemaking proposals, the implementation of statutory provisions, and even our own Departmental legislative proposals. In addition, over the past nine years, our headquarters staff 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 four biennial National meetings of State and Federal Program administrators (Seattle in 1996, New Orleans in 1998, Chicago in 2000, and New York in 2002); 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-California Sponsors 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 individual provisions were discussed in the meetings with State and local cooperators mentioned above. Although comments on the proposed rule indicated that State agencies and local sponsoring organizations had some concerns about some of our proposals, we have made appropriate adjustments to those proposals and have addressed these concerns in this interim rule.

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. Major adjustments made by this interim rule in response to public comment are discussed at length, especially in part II of the preamble.

Public Law 104–4

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 that would achieve the same result.

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) Sections 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 part 3015, which address administrative review procedures for disputes involving procurement by State agencies and institutions.

Paperwork Reduction Act

In accordance with section 3507(j) of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507 *et seq.*), the information collection and recordkeeping requirements included in this interim rule have been submitted to the Office of Management and Budget (OMB) for approval. Written comments on the information collection requirements in this rule must be received on or before (insert 60 days after publication of this interim rule) by the Office of Information and Regulatory Affairs, Office of Management and Budget (OMB), 3208 New Executive Office Building, Washington, DC 20503, Attention: Ms. Katherine Astrich, Desk Officer for the Food and Nutrition Service. A copy of these comments may also be sent to Mr. Robert Eadie at the address listed in the **ADDRESSES** section of this preamble. Commenters are asked to separate their remarks on information collection requirements from their comments on the remainder of the interim rule.

OMB is required to make a decision concerning the collection of information in this rule between 30 to 60 days after its publication in the **Federal Register**. Therefore, a comment to OMB is most likely to be considered if OMB receives it within 30 days of the publication of this interim rule. This does not affect the 180-day deadline for the public to comment to the Department on the substance of the interim rule.

Comments are invited on: (a) Whether the collection of information is necessary for the Agency to perform its functions of the agency and will have practical utility; (b) the accuracy of the Agency's estimate of the burden of collecting the information, including whether its methodology and assumptions are valid; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the information collection, including the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology. The title and description of the information collections are shown below with an estimate of the annual reporting and recordkeeping burdens. Included in the estimate is the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

Title: 7 CFR part 226, Child and Adult Care Food Program.

OMB Number: 0584–0055.

Expiration Date: January 31, 2007.

Type of request: Revision of existing collections.

Abstract: This rule revises: State agency criteria for approving and renewing institution applications; State- and institution-level monitoring requirements; Program training and other operating requirements for child care institutions and facilities; and other provisions which we are required to change as a result of the Healthy Meals Act, the PRWORA, and the Goodling Act. The changes are intended to improve Program operations and monitoring at the State and institution levels and, where possible, to streamline and simplify Program requirements for State agencies and institutions.

Estimated Total Annual Burden on Respondents:

Total Existing Burden Hours: 107,844.

Total Proposed Burden Hours: 111,398.

Total Difference: 3,654 hours.

Government Paperwork Elimination Act Compliance

FNS is committed to compliance with the Government Paperwork Elimination Act, which requires Government agencies to provide the public the option of submitting information or transacting business electronically to the maximum extent possible.

List of Subjects in 7 CFR Part 226

Accounting, Aged, Day care, Food and Nutrition Service, Food assistance programs, Grant programs, Grant programs—health, Indians, Individuals with disabilities, Infants and children, Intergovernmental relations, Loan programs, Reporting and recordkeeping requirements, Surplus agricultural commodities.

■ Accordingly, 7 CFR part 226 is amended as follows:

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. In part 226:

■ a. Remove the words ''AFDC case number'' wherever they appear and add, in their place, the words ''TANF case number''.

■ b. Remove the words ''AFDC recipiency'' wherever they appear and add, in their place, the words ''TANF recipiency''.

■ c. Remove the words ''AFDC Program'' wherever they appear and add, in their place, the words TANF Program''.

■ 3. In § 226.2:

■ a. The definition of AFDC assistance unit is removed.

■ b. The word ''enrolled'' is removed from the definition of *Outside-school-hours care center.*

■ c. New definitions of *Block claim* and *Household contact* are added in alphabetical order.

■ d. The definition of ''Documentation'' is amended in paragraph (b) by removing the words ''an AFDC assistance unit'' and adding in their place the words ''who is a TANF recipient''.

■ e. The definition of *TANF recipient* is added in alphabetical order.

■ f. The definition of ''verification'' is amended by removing the words ''AFDC assistance unit'' and adding in their place the words ''is a TANF recipient''.

The revision and additions specified above read as follows:

§ 226.2 Definitions.

* * * * *

Block claim means a claim for reimbursement submitted by a facility on which the number of meals claimed for one or more meal type (breakfast, lunch, snack, or supper) is identical for 15 consecutive days within a claiming period.

* * * * *

Household contact means a contact made by a sponsoring organization or a State agency to an adult member of a household with a child in a family day care home or a child care center in order to verify the attendance and enrollment of the child and the specific meal service(s) which the child routinely receives while in care.

* * * * *

TANF recipient means an individual or household receiving assistance (as defined in 45 CFR 260.31) under a State-administered Temporary Assistance to Needy Families program.

* * * * *

■ 4. In § 226.4:

■ a. Paragraph (g)(2) is amended by removing the word ''supplements'' and adding in its place the word ''meals'', and by removing the second sentence and adding two new sentences in its place.

■ b. Paragraph (h) is revised.

The addition and revision specified above read as follows:

§ 226.4 Payments to States and use of funds.

* * * * *

(g) * * *

(2) * * * Such adjustment must be rounded to the nearest lower cent, based on changes measured over the most recent twelve-month period for which data are available. The adjustment to the rates must be computed using the unrounded rate in effect for the preceding year.

* * * * *

(h) *Audit funds.* For the expense of conducting audits and reviews under § 226.8, funds shall be made available to each State agency in an amount equal to one and one-half percent of the Program reimbursement provided to institutions within the State during the second fiscal year preceding the fiscal year for which these funds are to be made available. In fiscal years 2005–2007, for the expense of conducting audits and reviews under § 226.8, funds shall be made available to each State agency in an amount equal to one percent of the Program reimbursement provided to institutions within the State during the second fiscal year preceding the fiscal year for which these funds are to be made available. The amount of assistance provided to a State under this paragraph in any fiscal year may not exceed the State's expenditures under § 226.8 during such fiscal year.

* * * * *

■ 5. In § 226.6:

■ a. Paragraphs (a) and (b) are revised.

■ b. Paragraphs (c)(2)(ii)(B) and (c)(3)(ii)(C) are amended by removing the reference ''paragraph (b)(18) of this section'' wherever it appears and adding, in its place, the reference ''paragraphs (b)(1)(xvii) and (b)(2)(vii) of this section''.

■ c. Paragraphs (c)(7)(ii), (c)(7)(iii), (c)(7)(iv)(A), (c)(7)(iv)(B), and (c)(7)(iv)(C) are amended by removing the reference ''paragraph (b)(12) of this section'' wherever it appears and adding, in its place, the reference ''paragraphs (b)(1)(xi) and (b)(2)(ii) of this section''.

■ d. Paragraphs (f) and (g) are revised.

■ e. Paragraph (h) is amended by revising the first sentence and by adding a new sentence after the first sentence.

■ f. Paragraphs (j) and (m) are revised.

■ g. The second and third sentences of paragraph (o) are revised.

■ h. A new paragraph (r) is added.

The additions and revisions specified above read as follows:

§ 226.6 State agency administrative responsibilities.

(a) *State agency personnel.* Each State agency must provide sufficient consultative, technical, and managerial personnel to:

(1) Administer the Program;

(2) Provide sufficient training and technical assistance to institutions;

(3) Monitor Program performance;

(4) Facilitate expansion of the Program in low-income and rural areas; and

(5) Ensure effective operation of the Program by participating institutions.

(b) *Program applications and agreements.* Each State agency must establish application review procedures, in accordance with paragraphs (b)(1) through (b)(3) of this section, to determine the eligibility of new institutions, renewing institutions, and facilities for which applications are submitted by sponsoring organizations. The State agency must enter into written agreements with institutions in accordance with paragraph (b)(4) of this section.

(1) *Application procedures for new institutions.* Each State agency must establish application procedures to determine the eligibility of new institutions under this part. At a minimum, such procedures must require that institutions submit information to the State agency in accordance with paragraph (f) of this section. For new private nonprofit and proprietary child care institutions, such procedures must also include a pre-approval visit by the State agency to confirm the information in the institution's application and to further assess its ability to manage the Program. The State agency must establish factors, consistent with § 226.16(b)(1), that it will consider in determining whether a new sponsoring organization has sufficient staff to perform required monitoring responsibilities at all of its sponsored facilities. As part of the review of the sponsoring organization's management plan, the State agency must determine the appropriate level of staffing for each sponsoring organization, consistent with the staffing range of monitors set forth at § 226.16(b)(1) and the factors it has established. The State agency must ensure that each new sponsoring organization applying for participation after July 29, 2002 meets this requirement. In addition, the State agency's application review procedures must ensure that the following information is included in a new institution's application:

(i) *Participant eligibility information.* Centers must submit current information on the number of enrolled participants who are eligible for free, reduced-price and paid meals;

(ii) *Enrollment information.* Sponsoring organizations of day care homes must submit current information on:

(A) The total number of children enrolled in all homes in the sponsorship;

(B) An assurance that day care home providers' own children whose meals are claimed for reimbursement in the Program are eligible for free or reduced-price meals;

(C) The total number of tier I and tier II day care homes that it sponsors;

(D) The total number of children enrolled in tier I day care homes;

(E) The total number of children enrolled in tier II day care homes; and

(F) The total number of children in tier II day care homes that have been identified as eligible for free or reduced-price meals;

(iii) *Nondiscrimination statement.* Institutions must submit their nondiscrimination policy statement and a media release, unless the State agency has issued a Statewide media release on behalf of all institutions;

(iv) *Management plan.* Sponsoring organizations must submit a complete management plan that includes:

(A) Detailed information on the organization's management and administrative structure;

(B) A list or description of the staff assigned to Program monitoring, in accordance with the requirements set forth at § 226.16(b)(1);

(C) An administrative budget that includes projected CACFP administrative earnings and expenses;

(D) The procedures to be used by the organization to administer the Program in, and disburse payments to, the child care facilities under its sponsorship; and

(E) For sponsoring organizations of family day care homes, a description of the system for making tier I day care home determinations, and a description of the system of notifying tier II day care homes of their options for reimbursement;

(v) *Budget.* An institution must submit a budget that the State agency must review in accordance with § 226.7(g);

(vi) *Documentation of licensing/approval.* All centers and family day care homes must document that they meet Program licensing/approval requirements;

(vii) *Documentation of tax-exempt status.* All private nonprofit institutions must document their tax-exempt status;

(viii) *Documentation of proprietary center eligibility.* Institutions must

document that each proprietary center for which application is made meets the definition of a title XIX center or a proprietary title XX center, as applicable and as set forth at § 226.2;

(ix) *Preference for commodities/cash-in-lieu of commodities.* Institutions must state their preference to receive commodities or cash-in-lieu of commodities;

(x) *Providing benefits to unserved facilities or participants.*

(A) *Criteria.* The State agency must develop criteria for determining whether a new sponsoring organization's participation will help ensure the delivery of benefits to otherwise unserved facilities or participants, and must disseminate these criteria to new sponsoring organizations when they request information about applying to the Program; and

(B) *Documentation.* The new sponsoring organization must submit documentation that its participation will help ensure the delivery of benefits to otherwise unserved facilities or participants in accordance with the State agency's criteria;

(xi) *Presence on National disqualified list.* If an institution or one of its principals is on the National disqualified list and submits an application, the State agency must deny 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 must deny the application;

(xii) *Ineligibility for other publicly funded programs.*

(A) *General.* A State agency is prohibited from approving an institution's application if, during the past seven years, the institution or any of its principals have been declared ineligible for any other publicly funded program by reason of violating that program's requirements. However, this prohibition does not apply if the institution or the principal has been fully reinstated in, or determined eligible for, that program, including the payment of any debts owed;

(B) *Certification.* Institutions must submit:

(*1*) A statement listing the publicly funded programs in which the institution and its principals have participated in the past seven years; and

(*2*) A certification that, during the past seven years, neither the institution nor any of its principals have been declared ineligible to participate in any other publicly funded program by reason of violating that program's requirements; or

(*3*) In lieu of the certification, documentation that the institution or the principal previously declared ineligible was later fully reinstated in, or determined eligible for, the program, including the payment of any debts owed; and

(C) *Follow-up.* If the State agency has reason to believe that the institution or its principals were determined ineligible to participate in another publicly funded program by reason of violating that program's requirements, the State agency must follow up with the entity administering the publicly funded program to gather sufficient evidence to determine whether the institution or its principals were, in fact, determined ineligible;

(xiii) *Information on criminal convictions.*

(A) A State agency is prohibited from approving an institution's application if the institution or any of its principals has been convicted of any activity that occurred during the past seven years and that indicated a lack of business integrity. A lack of business integrity includes fraud, antitrust violations, embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property, making false claims, obstruction of justice, or any other activity indicating a lack of business integrity as defined by the State agency; and

(B) Institutions must submit a certification that neither the institution nor any of its principals has been convicted of any activity that occurred during the past seven years and that indicated a lack of business integrity. A lack of business integrity includes fraud, antitrust violations, embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property, making false claims, obstruction of justice, or any other activity indicating a lack of business integrity as defined by the State agency;

(xiv) *Certification of truth of applications and submission of names and addresses.* Institutions must submit a certification that all information on the application is true and correct, along with the name, mailing address, and date of birth of the institution's executive director and chairman of the board of directors;

(xv) *Outside employment policy.* Sponsoring organizations must submit an outside employment policy. The policy must restrict other employment by employees that interferes with an employee's performance of Program-related duties and responsibilities, including outside employment that constitutes a real or apparent conflict of interest. Sponsoring organizations that are participating on July 29, 2002, must submit an outside employment policy not later than September 27, 2002. The policy will be effective unless disapproved by the State agency;

(xvi) *Bond.* Sponsoring organizations applying for initial participation on or after June 20, 2000, must submit a bond, if such bond is required by State law, regulation, or policy. If the State agency requires a bond for sponsoring organizations pursuant to State law, regulation, or policy, the State agency must submit a copy of that requirement and a list of sponsoring organizations posting a bond to the appropriate FNSRO on an annual basis; and

(xvii) *Compliance with performance standards.* Each new institution must submit information sufficient to document that it is financially viable, is administratively capable of operating the Program in accordance with this part, and has internal controls in effect to ensure accountability. To document this, any new institution must demonstrate in its application that it is capable of operating in conformance with the following performance standards. The State agency must only approve the applications of those new institutions that meet these performance standards, and must deny the applications of those new institutions that do not meet the standards.

(A) *Performance Standard 1—Financial viability and financial management.* The new institution must be financially viable. Program funds must be expended and accounted for in accordance with the requirements of this part, FNS Instruction 796–2 (''Financial Management in the Child and Adult Care Food Program''), and parts 3015, 3016, and 3019 of this title. To demonstrate financial viability, the new institution must document that it meets the following criteria:

(*1*) *Description of need/recruitment.* A new sponsoring organization must demonstrate in its management plan that its participation will help ensure the delivery of Program benefits to otherwise unserved facilities or participants, in accordance with criteria developed by the State agency pursuant to paragraph (b)(1)(x) of this section. A new sponsoring organization must demonstrate that it will use appropriate practices for recruiting facilities, consistent with paragraph (p) of this section and any State agency requirements;

(*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 withstand temporary interruptions in Program payments and/or fiscal claims against the institution, and can document financial viability (for example, through audits, financial statements, etc.); and

(*3*) *Budgets.* Costs in the institution's budget must be necessary, reasonable, allowable, and appropriately documented;

(B) *Performance Standard 2—Administrative capability.* The new institution must be administratively capable. Appropriate and effective management practices must be in effect to ensure that the Program operates in accordance with this part. To demonstrate administrative capability, the new institution must document that it meets the following criteria:

(*1*) Has an adequate number and type of qualified staff to ensure the operation of the Program in accordance with this part;

(*2*) If a sponsoring organization, documents in its management plan that it employs staff sufficient to meet the ratio of monitors to facilities, taking into account the factors that the State agency will consider in determining a sponsoring organization's staffing needs, as set forth in § 226.16(b)(1); and

(*3*) If a sponsoring organization, has Program policies and procedures in writing that assign Program responsibilities and duties, and ensure compliance with civil rights requirements; and

(C) *Performance Standard 3—Program accountability.* The new institution must have internal controls and other management systems in effect to ensure fiscal accountability and to ensure that the Program will operate in accordance with the requirements of this part. To demonstrate Program accountability, the new institution must document that it meets the following criteria:

(*1*) *Board of directors.* Has adequate oversight of the Program by its governing board of directors;

(*2*) *Fiscal accountability.* Has a financial system with management controls specified in writing. For new sponsoring organizations, these written operational policies must assure:

(*i*) Fiscal integrity and accountability for all funds and property received, held, and disbursed;

(*ii*) The integrity and accountability of all expenses incurred;

(*iii*) That claims will be processed accurately, and in a timely manner;

(*iv*) That funds and property are properly safeguarded and used, and expenses incurred, for authorized Program purposes; and

(*v*) That a system of safeguards and controls is in place to prevent and detect improper financial activities by employees;

(*3*) *Recordkeeping.* Maintains appropriate records to document compliance with Program requirements, including budgets, accounting records, approved budget amendments, and, if a sponsoring organization, management plans and appropriate records on facility operations;

(*4*) *Sponsoring organization operations.* If a new sponsoring organization, documents in its management plan that it will:

(*i*) Provide adequate and regular training of sponsoring organization staff and sponsored facilities in accordance with § 226.15(e)(12) and (e)(14) and § 226.16(d)(2) and (d)(3);

(*ii*) Perform monitoring in accordance with § 226.16(d)(4), to ensure that sponsored facilities accountably and appropriately operate the Program;

(*iii*) If a sponsor of family day care homes, accurately classify day care homes as tier I or tier II in accordance with § 226.15(f); and

(*iv*) Have a system in place to ensure that administrative costs funded from Program reimbursements do not exceed regulatory limits set forth at §§ 226.12(a) and 226.16(b)(1); and

(*5*) *Meal service and other operational requirements.* Independent centers and facilities will follow practices that result in the operation of the Program in accordance with the meal service, recordkeeping, and other operational requirements of this part. These practices must be documented in the independent center's application or in the sponsoring organization's management plan and must demonstrate that independent centers or sponsored facilities will:

(*i*) Provide meals that meet the meal patterns set forth in § 226.20;

(*ii*) Comply with licensure or approval requirements set forth in paragraph (d) of this section;

(*iii*) Have a food service that complies with applicable State and local health and sanitation requirements;

(*iv*) Comply with civil rights requirements;

(*v*) Maintain complete and appropriate records on file; and

(*vi*) Claim reimbursement only for eligible meals.

(2) *Application procedures for renewing institutions.* Each State agency must establish application procedures to determine the eligibility of renewing institutions under this part. Renewing institutions must not be required to submit a free and reduced-price policy statement or a nondiscrimination statement unless they make substantive changes to either statement. The State agency must require each renewing institution participating in the Program to reapply for participation at a time determined by the State agency, except that no institution may be allowed to participate for less than 12 or more than 36 calendar months under an existing application, except when the State agency determines that unusual circumstances warrant reapplication in less than 12 months. The State agency must establish factors, consistent with § 226.16(b)(1), that it will consider in determining whether a renewing sponsoring organization has sufficient staff to perform required monitoring responsibilities at all of its sponsored facilities. As part of the review of the renewing sponsoring organization's management plan, the State agency must determine the appropriate level of staffing for the sponsoring organization, consistent with the staffing range of monitors set forth at § 226.16(b)(1) and the factors it has established. The State agency must ensure that each currently participating sponsoring organization meets this requirement no later than July 29, 2003. At a minimum, the application review procedures established by the State agency must require that renewing institutions submit information to the State agency in accordance with paragraph (f) of this section. In addition, the State agency's application review procedures must ensure that the following information is included in a renewing institution's application:

(i) *Management plan.* For renewing sponsoring organizations, a complete management plan that meets the requirements of paragraphs (b)(1)(iv), (b)(1)(v), (f)(1)(vi), and (f)(3)(i) of this section and § 226.7(g);

(ii) *Presence on National disqualified list.* A renewing institution is prohibited from submitting a renewal application if it or any of its principals is currently on the National disqualified list. If such an institution submits an application, the State agency must deny the application. A renewing sponsoring organization is also prohibited from submitting a renewal application on behalf of a facility if the facility or any of its principals is on the National disqualified list. If a renewing sponsoring organization submits an application on behalf of such a facility, the State agency must deny the facility's application;

(iii) *Ineligibility for other publicly funded programs.*

(A) *General.* A State agency is prohibited from approving a renewing institution's application if, during the

past seven years, the institution or any of its principals have been declared ineligible for any other publicly funded program by reason of violating that program's requirements. However, this prohibition does not apply if the institution or the principal has been fully reinstated in, or determined eligible for, that program, including the payment of any debts owed;

(B) *Certification.* Renewing institutions must submit:

(*1*) A statement listing the publicly funded programs in which the institution and its principals have participated in the past seven years; and

(*2*) A certification that, during the past seven years, neither the institution nor any of its principals have been declared ineligible to participate in any other publicly funded program by reason of violating that program's requirements; or

(*3*) In lieu of the certification, documentation that the institution or the principal previously declared ineligible was later fully reinstated in, or determined eligible for, the program, including the payment of any debts owed; and

(C) *Follow-up.* If the State agency has reason to believe that the renewing institution or any of its principals were determined ineligible to participate in another publicly funded program by reason of violating that program's requirements, the State agency must follow up with the entity administering the publicly funded program to gather sufficient evidence to determine whether the institution or its principals were, in fact, determined ineligible;

(iv) *Information on criminal convictions.*

(A) A State agency is prohibited from approving a renewing institution's application if the institution or any of its principals have been convicted of any activity that occurred during the past seven years and that indicated a lack of business integrity. A lack of business integrity includes fraud, antitrust violations, embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property, making false claims, obstruction of justice, or any other activity indicating a lack of business integrity as defined by the State agency; and

(B) Renewing institutions must submit a certification that neither the institution nor any of its principals have been convicted of any activity that occurred during the past seven years and that indicated a lack of business integrity. A lack of business integrity includes fraud, antitrust violations, embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property, making false claims, obstruction of justice, or any other activity indicating a lack of business integrity as defined by the State agency;

(v) *Certification of truth of applications and submission of names and addresses.* Renewing institutions must submit a certification that all information on the application is true and correct, along with the name, mailing address, and date of birth of the institution's executive director and chairman of the board of directors;

(vi) *Outside employment policy.* Renewing sponsoring organizations must submit an outside employment policy. The policy must restrict other employment by employees that interferes with an employee's performance of Program-related duties and responsibilities, including outside employment that constitutes a real or apparent conflict of interest. Sponsoring organizations that are participating on July 29, 2002, must submit an outside employment policy not later than September 27, 2002. The policy will be effective unless disapproved by the State agency;

(vii) *Compliance with performance standards.* Each renewing institution must submit information sufficient to document that it is financially viable, is administratively capable of operating the Program in accordance with this part, and has internal controls in effect to ensure accountability. To document this, any renewing institution must demonstrate in its application that it is capable of operating in conformance with the following performance standards. The State agency must only approve the applications of those renewing institutions that meet these performance standards, and must deny the applications of those that do not meet the standards.

(A) *Performance Standard 1—Financial viability and financial management.* The renewing institution must be financially viable. Program funds must be expended and accounted for in accordance with the requirements of this part, FNS Instruction 796–2 (''Financial Management in the Child and Adult Care Food Program''), and parts 3015, 3016 and 3019 of this title. To demonstrate financial viability, the renewing institution must document that it meets the following criteria:

(*1*) *Description of need/recruitment.* A renewing sponsoring organization must demonstrate that it will use appropriate practices for recruiting facilities, consistent with paragraph (p) of this section and any State agency requirements;

(*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 withstand temporary interruptions in Program payments and/or fiscal claims against the institution, and can document financial viability (for example, through audits, financial statements, etc.); and

(*3*) *Budgets.* Costs in the renewing institution's budget must be necessary, reasonable, allowable, and appropriately documented;

(B) *Performance Standard 2—Administrative capability.* The renewing institution must be administratively capable. Appropriate and effective management practices must be in effect to ensure that the Program operates in accordance with this part. To demonstrate administrative capability, the renewing institution must document that it meets the following criteria:

(*1*) Has an adequate number and type of qualified staff to ensure the operation of the Program in accordance with this part;

(*2*) If a sponsoring organization, documents in its management plan that it employs staff sufficient to meet the ratio of monitors to facilities, taking into account the factors that the State agency will consider in determining a sponsoring organization's staffing needs, as set forth in § 226.16(b)(1); and

(*3*) If a sponsoring organization, has Program policies and procedures in writing that assign Program responsibilities and duties, and ensure compliance with civil rights requirements; and

(C) *Performance Standard 3—Program accountability.* The renewing institution must have internal controls and other management systems in effect to ensure fiscal accountability and to ensure that the Program operates in accordance with the requirements of this part. To demonstrate Program accountability, the renewing institution must document that it meets the following criteria:

(*1*) *Board of directors.* Has adequate oversight of the Program by its governing board of directors;

(*2*) *Fiscal accountability.* Has a financial system with management controls specified in writing. For sponsoring organizations, these written operational policies must assure:

(*i*) Fiscal integrity and accountability for all funds and property received, held, and disbursed;

(*ii*) The integrity and accountability of all expenses incurred;

(*iii*) That claims are processed accurately, and in a timely manner;

(*iv*) That funds and property are properly safeguarded and used, and expenses incurred, for authorized Program purposes; and

(*v*) That a system of safeguards and controls is in place to prevent and detect improper financial activities by employees;

(*3*) *Recordkeeping.* Maintains appropriate records to document compliance with Program requirements, including budgets, accounting records, approved budget amendments, and, if a sponsoring organization, management plans and appropriate records on facility operations;

(*4*) *Sponsoring organization operations.* A renewing sponsoring organization must document in its management plan that it will:

(*i*) Provide adequate and regular training of sponsoring organization staff and sponsored facilities in accordance with § 226.15(e)(12) and (e)(14) and § 226.16(d)(2) and (d)(3);

(*ii*) Perform monitoring in accordance with § 226.16(d)(4), to ensure that sponsored facilities accountably and appropriately operate the Program;

(*iii*) If a sponsor of family day care homes, accurately classify day care homes as tier I or tier II in accordance with § 226.15(f); and

(*iv*) Have a system in place to ensure that administrative costs funded from Program reimbursements do not exceed regulatory limits set forth at §§ 226.12(a) and 226.16(b)(1); and

(*5*) *Meal service and other operational requirements.* All independent centers and facilities must follow practices that result in the operation of the Program in accordance with the meal service, recordkeeping, and other operational requirements of this part. These practices must be documented in the independent center's application or in the sponsoring organization's management plan and must demonstrate that independent centers or sponsored facilities:

(*i*) Provide meals that meet the meal patterns set forth in § 226.20;

(*ii*) Comply with licensure or approval requirements set forth in paragraph (d) of this section;

(*iii*) Have a food service that complies with applicable State and local health and sanitation requirements;

(*iv*) Comply with civil rights requirements;

(*v*) Maintain complete and appropriate records on file; and

(*vi*) Claim reimbursement only for eligible meals.

(3) *State agency notification requirements.* Any new or renewing institution applying for participation in the Program must be notified in writing of approval or disapproval by the State agency, within 30 calendar days of the State agency's receipt of a complete application. Whenever possible, State agencies should provide assistance to institutions that have submitted an incomplete application. Any disapproved applicant institution or family day care home must be notified of the reasons for its disapproval and its right to appeal under paragraph (k) or (l), respectively, of this section.

(4) *Program agreements.* (i) The State agency must require each institution that has been approved for participation in the Program to enter into an agreement governing the rights and responsibilities of each party. The State agency may allow a renewing institution to amend its existing Program agreement in lieu of executing a new agreement. The existence of a valid agreement, however, does not eliminate the need for an institution to comply with the reapplication and related provisions at paragraphs (b) and (f) of this section.

(ii) State agencies may elect to enter into permanent agreements with institutions. However, if they elect not to enter into permanent agreements with institutions, the length of time during which such agreements are in effect must be no less than one and no more than three years, except that:

(A) The State agency and an institution that is a school food authority must enter into a single permanent agreement for all child nutrition programs administered by the school food authority and the State agency;

(B) If a State agency denies the application of a renewing institution, it must temporarily extend its agreement with that institution in accordance with paragraph (c)(2)(iii)(D) of this section;

(C) If the State agency determines that unusual circumstances warrant reapplication in less than 12 months, the State agency may approve the agreement with the institution for a period of less than one year.

(iii) Any agreement that extends from one fiscal year into the following fiscal year must stipulate that, in subsequent years, the agreement is in effect contingent upon the availability of Program funds. However, this does not limit the State agency's ability to terminate the agreement in accordance with paragraph (c) of this section.

(iv) The Program agreement must provide that the institution accepts final financial and administrative responsibility for management of a proper, efficient, and effective food service, and will comply with all requirements under this part. In addition, the agreement must state that the sponsor must comply with all requirements of title VI of the Civil Rights Act of 1964, title IX of the Education Amendments of 1972, section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975 and the Department's regulations concerning nondiscrimination (parts 15, 15a and 15b of this title), including requirements for racial and ethnic participation data collection, public notification of the nondiscrimination policy, and reviews to assure compliance with such policy, to the end that no person may, on the grounds of race, color, national origin, sex, age, or disability, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under, the Program.

(v) The Program agreement must also notify the institution of the right of the State agency, the Department, and other State or Federal officials to make announced or unannounced reviews of their operations during the institution's normal hours of child or adult care operations, and that anyone making such reviews must show photo identification that demonstrates that they are employees of one of these entities.

* * * * *

(f) *Miscellaneous responsibilities.* State agencies must require institutions to comply with the applicable provisions of this part and must provide or collect the information specified in this paragraph (f).

(1) *Annual responsibilities.* In addition to its other responsibilities under this part, each State agency must annually:

(i) Inform institutions that are pricing programs of their responsibility to ensure that free and reduced-price meals are served to participants unable to pay the full price;

(ii) Provide to all institutions a copy of the income standards to be used by institutions for determining the eligibility of participants for free and reduced-price meals under the Program;

(iii) Coordinate with the State agency that administers the National School Lunch Program to ensure the receipt of a list of elementary schools in the State in which at least one-half of the children enrolled are certified eligible to receive free or reduced-price meals. The State agency must provide the list to sponsoring organizations of day care homes by February 15 of each year, unless the State agency that administers the National School Lunch Program has elected to base data for the list on a month other than October, in which case the State agency must provide the list to such sponsoring organizations

within 15 calendar days of its receipt from the State agency that administers the National School Lunch Program. The State agency must also provide each sponsoring organization of day care homes with census data, as provided to the State agency by FNS upon its availability on a decennial basis, showing areas in the State in which at least 50 percent of the children are from households meeting the income standards for free or reduced-price meals. In addition, the State agency must ensure that the most recent available data is used if the determination of a day care home's eligibility as a tier I day care home is made using school or census data. Determinations of a day care home's eligibility as a tier I day care home must be valid for one year if based on a provider's household income, three years if based on school data, or until more current data are available if based on census data. However, a sponsoring organization, the State agency, or FNS may change the determination if information becomes available indicating that a day care home is no longer in a qualified area. The State agency must not routinely require annual redeterminations of the tiering status of tier I day care homes based on updated elementary school data;

(iv) Provide all sponsoring organizations of day care homes in the State with a listing of State-funded programs, participation in which by a parent or child will qualify a meal served to a child in a tier II home for the tier I rate of reimbursement;

(v) Require centers to submit current eligibility information on enrolled participants, in order to calculate a blended rate or claiming percentage in accordance with § 226.9(b);

(vi) Require each sponsoring organization to submit an administrative budget with sufficiently detailed information concerning projected CACFP administrative earnings and expenses, as well as other non-Program funds to be used in Program administration, for the State agency to determine the allowability, necessity, and reasonableness of all proposed expenditures, and to assess the sponsoring organization's capability to manage Program funds. The administrative budget must demonstrate that the sponsoring organization will expend and account for funds in accordance with regulatory requirements, FNS Instruction 796–2 (''Financial Management in the Child and Adult Care Food Program''), parts 3015, 3016, and 3019 of this title, and applicable Office of Management and Budget circulars. In addition, the administrative budget submitted by a sponsor of centers must demonstrate that the administrative costs to be charged to the Program do not exceed 15 percent of the meal reimbursements estimated or actually earned during the budget year, unless the State agency grants a waiver in accordance with § 226.7(g);

(vii) Require each institution to issue a media release, unless the State agency has issued a Statewide media release on behalf of all its institutions;

(viii) Require each independent center to provide information concerning its licensing/approval status, and require each sponsoring organization to provide information concerning the licensing/approval status of its facilities, unless the State agency has other means of confirming the licensing/approval status of any independent center or facility providing care;

(ix) Require each sponsoring organization to submit verification that all facilities under its sponsorship have adhered to the training requirements set forth in Program regulations; and

(x) Require each sponsoring organization of family day care homes to submit to the State agency a list of family day care home providers receiving tier I benefits on the basis of their participation in the Food Stamp Program. Within 30 days of receiving this list, the State agency will provide this list to the State agency responsible for the administration of the Food Stamp Program.

(2) *Triennial responsibilities.* In addition to its other responsibilities under this part, each State agency must, at intervals not to exceed 36 months:

(i) Require participating institutions to re-apply to continue their participation; and

(ii) Require sponsoring organizations to submit a management plan with the elements set forth in paragraph (b)(1)(iv) of this section.

(3) *Other responsibilities.* At intervals and in a manner specified by the State agency, but not more frequently than annually, the State agency may:

(i) Require independent centers to submit a budget with sufficiently detailed information and documentation to enable the State agency to make an assessment of the independent center's qualifications to manage Program funds. Such budget must demonstrate that the independent center will expend and account for funds in accordance with regulatory requirements, FNS Instruction 796–2 (''Financial Management in the Child and Adult Care Food Program''), parts 3015, 3016 and 3019 of this title and applicable Office of Management and Budget circulars;

(ii) Request institutions to report their commodity preference;

(iii) Require a private nonprofit institution to submit evidence of tax exempt status in accordance with § 226.15(a);

(iv) Require proprietary title XX child care centers to submit documentation that they are currently providing nonresidential day care services for which they receive compensation under title XX of the Social Security Act, and certification that not less than 25 percent of enrolled participants or 25 percent of the licensed capacity, whichever is less, in each such center during the most recent calendar month were title XX beneficiaries;

(v) Require proprietary title XIX or title XX adult care centers to submit documentation that they are currently providing nonresidential day care services for which they receive compensation under title XIX or title XX of the Social Security Act, and certification that not less than 25 percent of enrolled participants in each such center during the most recent calendar month were title XIX or title XX beneficiaries;

(vi) Request each institution to indicate its choice to receive all, part or none of advance payments, if the State agency chooses to make advance payments available; and

(vii) Perform verification in accordance with § 226.23(h) and paragraph (m)(4) of this section. State agencies verifying the information on free and reduced-price applications must ensure that verification activities are conducted without regard to the participant's race, color, national origin, sex, age, or disability.

(g) *Program expansion.* Each State agency must take action to expand the availability of benefits under this Program, and must conduct outreach to potential sponsoring organizations of family day care homes that might administer the Program in low-income or rural areas.

(h) * * * The State agency must require new institutions to state their preference to receive commodities or cash-in-lieu of commodities when they apply, and may periodically inquire as to participating institutions' preference to receive commodities or cash-in-lieu of commodities. State agencies must annually provide institutions with information on foods available in plentiful supply, based on information provided by the Department. * * *

* * * * *

(j) *Procurement provisions.* State agencies must require institutions to

adhere to the procurement provisions set forth in § 226.22 and must determine that all meal procurements with food service management companies are in conformance with bid and contractual requirements of § 226.22.

* * * * *

(m) *Program assistance.* (1) *General.* The State agency must provide technical and supervisory assistance to institutions and facilities to facilitate effective Program operations, monitor progress toward achieving Program goals, and ensure compliance with all requirements of title VI of the Civil Rights Act of 1964, title IX of the Education amendments of 1972, section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, and the Department's regulations concerning nondiscrimination (parts 15, 15a, and 15b of this title). The State agency must maintain documentation of supervisory assistance activities, including reviews conducted, corrective actions prescribed, and follow-up efforts.

(2) *Review priorities.* In choosing institutions for review, in accordance with paragraph (m)(6) of this section, the State agency must target for more frequent review institutions whose prior review included a finding of serious deficiency.

(3) *Review content.* As part of its conduct of reviews, the State agency must assess each institution's compliance with the requirements of this part pertaining to:

(i) Recordkeeping;

(ii) Meal counts;

(iii) Administrative costs;

(iv) Any applicable instructions and handbooks issued by FNS and the Department to clarify or explain this part, and any instructions and handbooks issued by the State agency which are not inconsistent with the provisions of this part;

(v) Facility licensing and approval;

(vi) Compliance with the requirements for annual updating of enrollment forms;

(vii) If an independent center, observation of a meal service;

(viii) If a sponsoring organization, training and monitoring of facilities;

(ix) If a sponsoring organization of day care homes, implementation of the serious deficiency and termination procedures for day care homes and, if such procedures have been delegated to sponsoring organizations in accordance with paragraph (l)(1) of this section, the administrative review procedures for day care homes;

(x) If a sponsoring organization, implementation of the household contact system established by the State agency pursuant to paragraph (m)(5) of this section;

(xi) If a sponsoring organization of day care homes, the requirements for classification of tier I and tier II day care homes; and

(xii) All other Program requirements.

(4) *Review of sponsored facilities.* As part of each required review of a sponsoring organization, the State agency must select a sample of facilities, in accordance with paragraph (m)(6) of this section. As part of such reviews, the State agency must conduct verification of Program applications in accordance with § 226.23(h) and must compare available enrollment and attendance records and the sponsoring organization's review results for that facility to meal counts submitted by those facilities for five days.

(5) *Household contacts.* As part of their monitoring of institutions, State agencies must establish systems for making household contacts to verify the enrollment and attendance of participating children. Such systems must specify the circumstances under which household contacts will be made, as well as the procedures for conducting household contacts. In addition, State agencies must establish a system for sponsoring organizations to use in making household contacts as part of their review and oversight of participating facilities. Such systems must specify the circumstances under which household contacts will be made, as well as the procedures for conducting household contacts. State agencies must submit to FNSROs, no later than April 1, 2005, the policies and procedures they have developed governing household contacts conducted by both the State agency, as part of institution and facility reviews conducted in accordance with this paragraph (m), and by sponsoring organizations as part of the facility review process described in § 226.16(d)(5).

(6) *Frequency and number of required institution reviews.* The State agency must annually review at least 33.3 percent of all institutions. At least 15 percent of the total number of facility reviews required must be unannounced. The State agency must review institutions according to the following schedule:

(i) Independent centers and sponsoring organizations of 1 to 100 facilities must be reviewed at least once every three years. A review of such a sponsoring organization must include reviews of 10 percent of the sponsoring organization's facilities;

(ii) Sponsoring organizations with more than 100 facilities must be reviewed at least once every two years. These reviews must include reviews of 5 percent of the first 1,000 facilities and 2.5 percent of the facilities in excess of 1,000; and

(iii) New institutions that are sponsoring organizations of five or more facilities must be reviewed within the first 90 days of Program operations.

* * * * *

(o) * * * If violations are not corrected within the specified timeframe for corrective action, the State agency must issue a notice of serious deficiency in accordance with paragraph (c) of this section or § 226.16(l), as appropriate. However, if the health or safety of the children is imminently threatened, the State agency or sponsoring organization must follow the procedures set forth at paragraph (c)(5)(i) of this section, or § 226.16(l)(4), as appropriate. * * *

* * * * *

(r) *WIC program information.* State agencies must provide information on the importance and benefits of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) and WIC income eligibility guidelines, to participating institutions. In addition, the State agency must ensure that:

(1) Participating family day care homes and sponsored child care centers receive this information, and periodic updates of this information, from their sponsoring organizations or the State agency; and

(2) The parents of enrolled children also receive this information.

■ 6. In § 226.7:

■ a. Paragraph (g) is revised.

■ b. Paragraph (k) is amended by adding a new sentence after the first sentence.

The revision and addition specified above read as follows:

§ 226.7 State agency responsibilities for financial management.

* * * * *

(g) *Budget approval.* The State agency must review institution budgets and must limit allowable administrative claims by each sponsoring organization to the administrative costs approved in its budget. The budget must demonstrate the institution's ability to manage Program funds in accordance with this part, FNS Instruction 796–2 (''Financial Management in the Child and Adult Care Food Program''), parts 3015, 3016, and 3019 of this title, and applicable Office of Management and Budget circulars. Sponsoring organizations must submit an administrative budget to the State agency annually, and independent centers must submit budgets as

frequently as required by the State agency. Budget levels may be adjusted to reflect changes in Program activities. For sponsoring organizations of centers, the State agency is prohibited from approving the sponsoring organization's administrative budget, or any amendments to the budget, if the administrative budget shows the Program will be charged for administrative costs in excess of 15 percent of the meal reimbursements estimated to be earned during the budget year. However, the State agency may waive this limit if the sponsoring organization provides justification that it requires Program funds in excess of 15 percent to pay its administrative costs and if the State agency is convinced that the institution will have adequate funding to provide meals meeting the requirements of § 226.20. The State agency must document all waiver approvals and denials in writing, and must provide a copy of all such letters to the appropriate FNSRO.

* * * * *

(k) * * * Such procedures must include State agency edit checks, including but not limited to ensuring that payments are made only for approved meal types and that the number of meals for which reimbursement is provided does not exceed the product of the total enrollment times operating days times approved meal types. * * *

* * * * *

■ 7. In § 226.8:

■ a. Paragraphs (a) and (b) are revised.

■ b. Paragraph (c) is amended by adding the words ''or agreed-upon procedures engagements' after the words ''administrative reviews'' in the second sentence.

The revisions specified above read as follows:

§ 226.8 Audits.

(a) Unless otherwise exempt, audits at the State and institution levels must be conducted in accordance with Office of Management and Budget circular A–133 and the Department's implementing regulations at part 3052 of this title. State agencies must establish audit policy for title XIX and title XX proprietary institutions. However, the audit policy established by the State agency must not conflict with the authority of the State agency or the Department to perform, or cause to be performed, audits, reviews, agreed-upon procedures engagements, or other monitoring activities.

(b) The funds provided to the State agency under § 226.4(h) may be made available to institutions to fund a portion of organization-wide audits made in accordance with part 3052 of this title. The funds provided to an institution for an organization-wide audit must be determined in accordance with § 3052.230(a) of this title.

* * * * *

■ 8. In § 226.10:

■ a. The first sentence of paragraph (a) is revised.

■ b. Paragraph (c) is amended by adding two new sentences at the end of the introductory text and by adding new paragraphs (c)(1), (c)(2), and (c)(3).

■ c. Paragraph (f) is revised.

The addition and revisions specified above read as follows:

§ 226.10 Program payment procedures.

(a) If a State agency elects to issue advance payments to all or some of the participating institutions in the State, it must provide such advances no later than the first day of each month to those eligible institutions electing to receive advances in accordance with § 226.6 (f)(3)(vi). * * *

* * * * *

(c) * * * Prior to submitting its consolidated monthly claim to the State agency, each sponsoring organization must perform edit checks on each facility's meal claim. At a minimum, the sponsoring organization's edit checks must:

(1) Verify that each facility has been approved to serve the types of meals claimed;

(2) Compare the number of children enrolled for care at each facility, multiplied by the number of days on which the facility is approved to serve meals, to the total number of meals claimed by the facility for that month. Discrepancies between the facility's meal claim and its enrollment must be subjected to more thorough review to determine if the claim is accurate; and

(3) Detect block claiming (as defined in § 226.2) by any facility. 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. In addition, if a State agency determines that the conduct of all required unannounced reviews within 60 days will impose unwarranted burdens on a particular sponsoring organization, the State agency may provide that sponsoring organization with up to 30 additional days to complete the required unannounced reviews.

* * * * *

(f) If, based on the results of audits, investigations, or other reviews, a State agency has reason to believe that an institution, child or adult care facility, or food service management company has engaged in unlawful acts with respect to Program operations, the evidence found in audits, investigations, or other reviews is a basis for non-payment of claims for reimbursement.

■ 9. In § 226.11:

■ a. The section heading is revised.

■ b. Paragraph (a) is amended by removing the second sentence and adding two new sentences in its place.

■ c. Paragraph (b) is amended by adding a new sentence to the end of the paragraph.

■ d. Paragraph (c)(1) is revised.

The additions and revision specified above read as follows:

§ 226.11 Program payments for centers.

(a) * * * A State agency may develop a policy under which centers are reimbursed for meals served in accordance with provisions of the Program in the calendar month preceding the calendar month in which the agreement is executed, or the State agency may develop a policy under which centers earn reimbursement only for meals served in approved centers on or after the effective date of the Program agreement. If the State agency's policy permits centers to earn reimbursement for meals served prior to the execution of a Program agreement, Program reimbursement must not be received by the center until the agreement is executed.

(b) * * * Prior to submitting its consolidated monthly claim to the State agency, each sponsoring organization must conduct reasonable edit checks on the sponsored centers' meal claims which, at a minimum, include those edit checks specified at § 226.10(c).

(c) * * *

(1) Base reimbursement to child care centers and adult day care centers on actual time of service meal counts, and multiply the number of meals, by type, served to participants eligible to receive free meals, served to participants eligible to receive reduced-price meals, and served to participants from families

not meeting such standards by the applicable national average payment rate; or

* * * * *

■ 10. In § 226.13:

■ a. Paragraph (b) is amended by adding a new sentence to the end of the paragraph; and

■ b. Paragraph (c) is amended by adding the words ''based on daily meal counts taken in the home'' after the words ''as applicable,''.

The addition specified above reads as follows:

§ 226.13 Food service payments to sponsoring organizations for day care homes.

* * * * *

(b) * * * Prior to submitting its consolidated monthly claim to the State agency, each sponsoring organization must conduct reasonable edit checks on the day care homes' meal claims which, at a minimum, include those edit checks specified at § 226.10(c).

* * * * *

§ 226.14 [Amended]

■ 11. In § 226.14(a), the reference ''§ 226.6(f)(3)'' is removed and the reference § 226.7(g)'' is added in its place.

■ 12. In § 226.15:

■ a. Paragraph (b) is revised.

■ b. Paragraph (e)(2) is revised.

■ c. Paragraph (e)(3) is amended by adding a new sentence to the end of the paragraph.

■ d. Paragraph (e)(4) is revised.

■ e. Paragraph (e)(5) is removed and paragraphs (e)(6) through (e)(14) are redesignated as paragraphs (e)(5) through (e)(13), respectively.

■ f. New paragraph (e)(14) is added.

■ g. Paragraphs (g) through (k) are redesignated as paragraphs (h) through (l), and a new paragraph (g) is added.

■ h. Newly redesignated paragraph (i) is amended by removing the reference ''§ 226.6(f)(1)'' and adding in its place the reference ''§ 226.6(b)(4)''.

■ i. New paragraphs (m) and (n) are added.

The additions and revisions specified above read as follows:

§ 226.15 Institution provisions.

* * * * *

(b) *New applications and renewals*. Each institution must submit to the State agency with its application all information required for its approval as set forth in § 226.6(b) and 226.6(f). Such information must demonstrate that a new institution has the administrative and financial capability to operate the Program in accordance with this part and with the performance standards set forth in § 226.6(b)(1)(xvii), and that a renewing institution has the administrative and financial capability to operate the Program in accordance with this part and with the performance standards set forth in § 226.6(b)(2)(vii).

* * * * *

(e) * * *

(2) Documentation of the enrollment of each participant at child care centers (except for outside-school-hours care centers) and adult day care centers. All types of centers must maintain information used to determine eligibility for free or reduced-price meals in accordance with § 226.23(e)(1). For child care centers, such documentation of enrollment must be updated annually, signed by a parent or legal guardian, and include information on each child's normal days and hours of care and the meals normally received while in care.

(3) * * * Such documentation of enrollment must be updated annually, signed by a parent or legal guardian, and include information on each child's normal days and hours of care and the meals normally received while in care.

(4) Daily records indicating the number of participants in attendance and the daily meal counts, by type (breakfast, lunch, supper, and snacks), served to family day care home participants, or the time of service meal counts, by type (breakfast, lunch, supper, and snacks), served to center participants. State agencies may require family day care homes to record meal counts at the time of meal service only in day care homes providing care for more than 12 children in a single day, or in day care homes that have been found seriously deficient due to problems with their meal counts and claims.

* * * * *

(14) For sponsoring organizations, records documenting the attendance at training of each staff member with monitoring responsibilities. Training must include instruction, appropriate to the level of staff experience and duties, on the Program's meal patterns, meal counts, claims submission and claim review procedures, recordkeeping requirements, and an explanation of the Program's reimbursement system.

* * * * *

(g) *Payment to employees*. No institution that is a sponsoring organization of family day care homes and that employs more than one person is permitted to base payment (including bonuses or gratuities) to its employees, contractors, or family day care home providers solely on the number of new family day care homes recruited for the sponsoring organization's Program.

* * * * *

(m) *Regulations and guidance*. Each institution must comply with all regulations issued by FNS and the Department, all instructions and handbooks issued by FNS and the Department to clarify or explain existing regulations, and all regulations, instructions and handbooks issued by the State agency that are consistent with the provisions established in Program regulations.

(n) *Information on WIC*. Each institution must ensure that parents of enrolled children are provided with current information on the benefits and importance of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) and the eligibility requirements for WIC participation.

■ 13. In § 226.16:

■ a. The introductory text to paragraph (b) and paragraph (b)(1) are revised.

■ b. Paragraphs (d)(2), (d)(3) and (d)(4) are revised.

■ c. New paragraph (d)(5) is added.

■ d. Paragraph (l)(2)(vii) is amended by removing the word ''or'' after the semicolon.

■ e. Paragraph (l)(2)(viii) is redesignated as (l)(2)(ix) and a new paragraph (l)(2)(viii) is added in its place.

■ f. New paragraph (m) is added.

The additions and revisions specified above read as follows:

§ 226.16 Sponsoring organization provisions.

* * * * *

(b) Each sponsoring organization must submit to the State agency with its application all information required for its approval, and the approval of the facilities under its jurisdiction, as set forth in §§ 226.6(b) and 226.6(f). The application must demonstrate that the institution has the administrative and financial capability to operate the Program in accordance with the Program regulations. In addition to the information required in §§ 226.6(b) and 226.6(f), the application must include:

(1) A sponsoring organization management plan and administrative budget, in accordance with §§ 226.6(b)(1)(iv), 226.6(b)(1)(v), 226.6(b)(2)(i), 226.6(f)(2)(ii), and 226.7(g), which includes information sufficient to document the sponsoring organization's compliance with the performance standards set forth at § 226.6(b)(1)(xvii) and 226.6(b)(2)(vii). As part of its management plan, a sponsoring organization of day care homes must document that, to perform monitoring, it will employ the equivalent of one full-time staff person

for each 50 to 150 day care homes it sponsors. As part of its management plan, a sponsoring organization of centers must document that, to perform monitoring, it will employ the equivalent of one full-time staff person for each 25 to 150 centers it sponsors. It is the State agency's responsibility to determine the appropriate level of staffing for monitoring for each sponsoring organization, consistent with these specified ranges and factors that the State agency will use to determine the appropriate level of monitoring staff for each sponsor. The monitoring staff equivalent may include the employee's time spent on scheduling, travel time, review time, follow-up activity, report writing, and activities related to the annual updating of children's enrollment forms. Sponsoring organizations that were participating in the Program on July 29, 2002, were to have submitted, no later than July 29, 2003, a management plan or plan amendment that meets the monitoring staffing requirement. For sponsoring organizations of centers, the portion of the administrative costs to be charged to the Program may not exceed 15 percent of the meal reimbursements estimated or actually earned during the budget year, unless the State agency grants a waiver in accordance with § 226.7(g). A sponsoring organization of centers must include in the administrative budget all administrative costs, whether incurred by the sponsoring organization or its sponsored centers. If at any point a sponsoring organization determines that the meal reimbursements estimated to be earned during the budget year will be lower than that estimated in its administrative budget, the sponsoring organization must amend its administrative budget to stay within the 15 percent limitation (or any higher limit established pursuant to a waiver granted under § 226.7(g)) or seek a waiver. Failure to do so will result in appropriate fiscal action in accordance with § 226.14(a).

* * * * *

(d) * * *

(2) Training on Program duties and responsibilities to key staff from all sponsored facilities prior to the beginning of Program operations. At a minimum, such training must include instruction, appropriate to the level of staff experience and duties, on the Program's meal patterns, meal counts, claims submission and review procedures, recordkeeping requirements, and reimbursement system. Attendance by key staff, as defined by the State agency, is mandatory;

(3) Additional mandatory training sessions for key staff from all sponsored child care and adult day care facilities not less frequently than annually. At a minimum, such training must include instruction, appropriate to the level of staff experience and duties, on the Program's meal patterns, meal counts, claims submission and review procedures, recordkeeping requirements, and reimbursement system. Attendance by key staff, as defined by the State agency, is mandatory;

(4)(i) *Review elements.* Reviews that assess whether the facility has corrected problems noted on the previous review(s), a reconciliation of the facility's meal counts with enrollment and attendance records for a five-day period, as specified in paragraph (d)(4)(ii) of this section, and an assessment of the facility's compliance with the Program requirements pertaining to:

(A) The meal pattern;

(B) Licensing or approval;

(C) Attendance at training;

(D) Meal counts;

(E) Menu and meal records; and

(F) The annual updating and content of enrollment forms (if the facility is required to have enrollment forms on file, as specified in § 226.15(e)(2) and 226.15(e)(3)).

(ii) *Reconciliation of meal counts.* Reviews must examine the meal counts recorded by the facility for five consecutive days during the current and/or prior claiming period. For each day examined, reviewers must use enrollment and/or attendance records to determine the number of children in care during each meal service and attempt to reconcile those numbers to the numbers of breakfasts, lunches, suppers, and/or snacks recorded in the facility's meal count for that day. Based on that comparison, reviewers must determine whether the meal counts were accurate. If there is a discrepancy between the number of children enrolled or in attendance on the day of review and prior meal counting patterns, the reviewer must attempt to reconcile the difference and determine whether the establishment of an overclaim is necessary.

(iii) *Frequency and type of required facility reviews.* Sponsoring organizations must review each facility three times each year, except as described in paragraph (d)(4)(iv) of this section. In addition:

(A) At least two of the three reviews must be unannounced;

(B) At least one unannounced review must include observation of a meal service;

(C) At least one review must be made during each new facility's first four weeks of Program operations; and

(D) Not more than six months may elapse between reviews.

(iv) *Averaging of required reviews.* If a sponsoring organization conducts two unannounced reviews 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, provided that the sponsoring organization conducts an average of three 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. Sponsoring organizations may not review a sponsored facility fewer than three times per year if the facility has submitted a block claim during the year.

(v) *Follow-up reviews.* If, in conducting a facility review, a sponsoring organization detects one or more serious deficiency, the next review of that facility must be unannounced. Serious deficiencies are those described at paragraph (l)(2) of this section, regardless of the type of facility.

(vi) *Notification of unannounced reviews.* Sponsoring organizations of centers must provide each center with written notification of the right of the sponsoring organization, the State agency, the Department, and other State and Federal officials to make announced or unannounced reviews of its operations during the center's normal hours of operation, and must also notify sponsored centers that anyone making such reviews must show photo identification that demonstrates that they are employees of one of these entities. For sponsored centers participating on July 29, 2002, the sponsoring organization was to have provided this notice no later than August 29, 2002. For sponsored centers that are approved after July 29, 2002, the sponsoring organization must provide the notice before meal service under the Program begins. Sponsoring organizations must provide day care homes notification of unannounced visits in accordance with § 226.18(b)(1).

(vii) *Other requirements pertaining to unannounced reviews.* Unannounced reviews must be made only during the facility's normal hours of operation, and monitors making such reviews must show photo identification that demonstrates that they are employees of the sponsoring organization, the State

agency, the Department, or other State and Federal agencies authorized to audit or investigate Program operations.

ii) *Imminent threat to health or safety.* Sponsoring organizations that discover in a facility conduct or conditions that pose an imminent threat to the health or safety of participating children or the public, must immediately notify the appropriate State or local licensing or health authorities and take action that is consistent with the recommendations and requirements of those authorities.

(5) For sponsoring organizations, as part of their monitoring of facilities, compliance with the household contact requirements established pursuant to § 226.6(m)(5) of this part.

* * * * *

(l) * * *

(2) * * *

(viii) Failure to participate in training; or

* * * * *

(m) Sponsoring organizations of family day care homes must not make payments to employees or contractors solely on the basis of the number of homes recruited. However, such employees or contractors may be paid or evaluated on the basis of recruitment activities accomplished.

■ 14. In § 226.17:

■ a. Paragraph (b)(3) is amended by removing the words '', except that reimbursement may be claimed for two meals and two snacks or three meals and one snack served to a child for each day in which that child is maintained in care for eight or more hours''.

■ b. Paragraph (b)(7) is amended by adding a new sentence at the end of the paragraph.

■ c. Paragraph (b)(8) is revised. d. A new paragraph (b)(9) is added.

The additions and revision specified above read as follows:

§ 226.17 Child care center provisions.

* * * * *

(b) * * *

(7) * * * Such documentation of enrollment must be updated annually, signed by a parent or legal guardian, and include information on each child's normal days and hours of care and the meals normally received while in care.

(8) Each child care center must maintain daily records of time of service meal counts by type (breakfast, lunch, supper, and snacks) served to enrolled children, and to adults performing labor necessary to the food service.

(9) Each child care center must require key staff, as defined by the State agency, to attend Program training prior to the center's participation in the Program, and at least annually thereafter, on content areas established by the State agency.

* * * * *

■ 15. In § 226.18:

■ a. Paragraph (b)(2) is revised.

■ b. Paragraph (b)(7) is amended by removing the semicolon at the end of the paragraph and adding a period in its place, and by adding a new sentence at the end of the paragraph.

■ c. Paragraph (e) is amended by removing the first sentence and adding two new sentences in its place.

The revisions and additions specified above read as follows:

§ 226.18 Day care home provisions.

* * * * *

(b) * * *

(2) The responsibility of the sponsoring organization to require key staff, as defined by the State agency, to receive Program training prior to the day care home's participation in the Program, and at least annually thereafter, on content areas established by the State agency, and the responsibility of the day care home to participate in that training;

* * * * *

(7) * * * The sponsoring organization must not withhold Program payments to any family day care home for any other reason, except that the sponsoring organization may withhold from the provider any amounts that the sponsoring organization has reason to believe are invalid, due to the provider having submitted a false or erroneous meal count;

* * * * *

(e) Each day care home must maintain on file documentation of each child's enrollment and must maintain daily records of the number of children in attendance and the number of meals, by type, served to enrolled children. Such documentation of enrollment must be updated annually, signed by a parent or legal guardian, and include information on each child's normal days and hours of care and the meals normally received while in care. * * *

* * * * *

■ 16. In § 226.19:

■ a. Paragraph (b)(6) is removed and paragraphs (b)(7) through (b)(9) are redesignated as paragraphs (b)(6) through (b)(8), respectively.

■ b. Paragraphs (b)(1) and (b)(4), and newly redesignated paragraphs (b)(7)(iv) and (b)(7)(v), are amended by removing the word ''enrolled'' wherever it occurs.

■ c. Paragraph (b)(3)(i) is revised.

■ d. Paragraph (b)(5) is amended by removing the words '', except that reimbursement may be claimed for two meals and two snacks or three meals and one snack served to a child for each day in which that child is maintained in care for eight or more hours''.

■ e. Paragraph (b)(5) is further amended by removing the words ''meals served to children who are not enrolled, for'' from the third sentence.

■ f. The introductory text of newly redesignated paragraph (b)(6) is revised.

■ g. Newly redesignated paragraph (b)(6)(i) is amended by removing the words ''enrolled for care and'' and adding in their place the words ''and to''.

■ h. Newly redesignated paragraph (b)(6)(iii) is removed and newly redesignated paragraphs (b)(6)(iv), (b)(6)(v), and (b)(6)(vi) are redesignated as paragraphs (b)(6)(iii), (b)(6)(iv), and (b)(6)(v), respectively.

■ i. Newly redesignated paragraph (b)(7)(i) is amended by removing the words ''Documentation of enrollment for all children, including information'', and adding the word ''Information'' in their place.

The revisions specified above read as follows:

§ 226.19 Outside-school-hours care center provisions.

* * * * *

(b) * * *

(3) * * *

(i) Children participate in a regularly scheduled program that meets the criteria of paragraph (b)(1) of this section. The program is organized for the purpose of providing services to children and is distinct from any extracurricular programs organized primarily for scholastic, cultural, or athletic purposes; and

* * * * *

(6) Each outside-school-hours care center must require key operational staff, as defined by the State agency, to attend Program training prior to the center's participation in the Program, and at least annually thereafter, on content areas established by the State agency. Each meal service must be supervised by an adequate number of operational personnel who have been trained in Program requirements as outlined in this section. Operational personnel must ensure that:

* * * * *

■ 17. In § 226.19a:

■ a. Paragraph (b)(9) is revised.

■ b. A new paragraph (b)(11) is added.

The addition and revision specified above read as follows:

§ 226.19a Adult day care center provisions.

* * * * *

(b) * * *

(9) Each adult day care center must maintain daily records of time of service

meal counts by type (breakfast, lunch, supper, and snacks) served to enrolled participants, and to adults performing labor necessary to the food service.

* * * * *

(11) Each adult day care center must require key operational staff, as defined by the State agency, to attend Program training prior to the facility's participation in the Program, and at least annually thereafter, on content areas established by the State agency. Each meal service must be supervised by an adequate number of operational personnel who have been trained in Program requirements as outlined in this section.

* * * * *

■ 18. In § 226.20, paragraphs (k) through (p) are redesignated as paragraphs (l) through (q), respectively, and a new paragraph (k) is added to read as follows:

§ 226.20 Requirements for meals.

* * * * *

(k) *Time of meal service.* State agencies may require any institution or facility to allow a specific amount of time to elapse between meal services or require that meal services not exceed a specified duration.

* * * * *

■ 19. In § 226.23:

■ a. Paragraph (a) is revised.

■ b. Paragraph (c)(2) is amended by removing the words ''members of AFDC assistance units or'' and adding in their place the words ''TANF recipients or who are members of''.

■ c. The first sentence of paragraph (d) is amended by removing the period after the words ''public release'' and adding in its place the words '', unless the State agency has issued a Statewide media release on behalf of all institutions.''

■ d. The fifth sentence of paragraph (d) is amended by removing the words ''members of AFDC assistance units'' and adding in their place the words ''TANF recipients''.

■ e. Paragraph (e)(1)(i) is amended by removing the words ''or AFDC assistance unit'' and adding in their place the words ''or is a TANF recipient''.

■ f. Paragraph (e)(1)(iv) is amended by removing the words ''AFDC assistance units'' the first time they appear, and adding in their place the words ''who are TANF recipients'', and by removing the words ''AFDC assistance units'' the second time they appear, and adding in their place the words ''children who are TANF recipients''.

■ g. Paragraph (e)(1)(iv)(B) is amended by removing the words ''AFDC benefits'' and adding in their place the words ''TANF benefits''.

■ h. Paragraph (h)(2)(i)(A) is amended by removing the words ''AFDC assistance unit'' and adding in their place the words ''is a TANF recipient''.

■ i. Paragraph (h)(2)(iii)(D) is amended by removing the word ''AFDC'' and adding in its place the word ''TANF''.

■ j. Paragraph (h)(2)(v)(C) is amended by removing the words ''food stamp/FDPIR/AFDC'' and adding in their place the words ''food stamp/FDPIR/TANF''.

■ k. Paragraph (h)(2)(vi) is amended by removing the word ''AFDC'' and adding in its place the word ''TANF''.

The revision specified above reads as follows:

§ 226.23 Free and reduced-price meals.

(a) The State agency must not enter into a Program agreement with a new institution until the institution has submitted, and the State agency has approved, a written policy statement concerning free and reduced-price meals to be used in all child and adult day care facilities under its jurisdiction, as described in paragraph (b) of this section. The State agency must not require an institution to revise its free and reduced-price policy statement or its nondiscrimination statement unless the institution makes a substantive change to either policy. Pending approval of a revision to these statements, the existing policy must remain in effect.

* * * * *

§ 226.25 [Amended]

■ 19. In § 226.25, paragraph (g) is removed.

Dated: August 20, 2004.

Eric M. Bost,

Under Secretary for Food, Nutrition, and Consumer Services.

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