DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

7 CFR Part 226

RIN 0584–AC94

Child and Adult Care Food Program; Implementing Legislative Reforms To Strengthen Program Integrity

AGENCY: Food and Nutrition Service, USDA.

ACTION: Interim rule.

SUMMARY: This rule incorporates in the Child and Adult Care Food Program regulations the changes mandated by the Agricultural Risk Protection Act of 2000 and the Grain Standards and Warehouse Improvement Act of 2000. The changes made by these laws that affect the Child and Adult Care Food Program were enacted due to concerns resulting from the findings of State and Federal Program reviews and from audits and investigations conducted by the Department's Office of Inspector General. The changes made by this rule are in several broad Program areas: the basic eligibility criteria for participation by institutions; procedures for denying institutions' applications and for terminating agreements with institutions and day care homes that do not meet Program requirements; administrative review procedures for institutions and day care homes; State agency and sponsoring organization monitoring requirements; limits on the amount of reimbursable administrative costs for sponsors of centers; and State agency controls on day care home participation. The changes are designed to improve Program operations and monitoring at the State agency and institution levels.

DATES: The effective date for this rule is July 29, 2002. For sponsoring organizations participating in the Program as of the date of publication, the provision at § 226.16(b)(1) relating to the appropriate level of monitoring staff must be implemented no later than July 29, 2003. To be assured of consideration, comments must be postmarked on or before December 24, 2002. Comments will also be accepted via E Mail if sent to *CNDPROPOSAL@FNS.USDA.GOV* no later than 11:59 p.m. on December 24, 2002.

ADDRESSES: 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. Comments will also be accepted via E Mail sent to *CNDPROPOSAL@FNS.USDA.GOV.* All written submissions will be available for public inspection at this location Monday through Friday, 8:30 a.m.–5 p.m.

FOR FURTHER INFORMATION CONTACT: Mr. Edward Morawetz or Ms. Melissa Rothstein at the above address or by telephone at (703) 305–2620. 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 Ms. Rothstein.

SUPPLEMENTARY INFORMATION:

Background

What Led to the Increased Focus on Program Management and Integrity in the Child and Adult Care Food Program?

In recent years, State and Federal reviews of the Child and Adult Care Food Program (CACFP or Program) have found a number of cases of mismanagement, abuse, and, in some instances, fraud by institutions and facilities participating in the CACFP. (''Institution'' means an independent center or a sponsoring organization that holds an agreement with the State agency to administer CACFP. ''Facility'' will be defined in this rule to mean any center or day care home participating in CACFP under a sponsoring organization. ''Center'' will be defined in this rule to include child care centers, adult day care centers, and outside-school-hours centers). These reviews revealed critical weaknesses in State agency and institution management controls over Program operations, and examples of regulatory noncompliance by institutions and facilities, including improper use of Program funds. In addition, audits and investigations conducted by the Department's Office of Inspector General (OIG) raised serious concerns regarding the adequacy of financial and administrative controls in CACFP and documented instances of mismanagement and, in some cases, fraud, by Program participants. Finally, the General Accounting Office conducted a review of the CACFP which raised questions concerning Federal and State administration of the Program.

What Did the Department Do in Response to These Audits, Investigations, and Reviews?

In 1995, we convened a working group of State and Federal Program administrators to address the issues raised in these reviews and audits. Based on input from this group, that identified the most critical and vulnerable aspects of Program management in day care homes and child care centers, we developed and disseminated guidance on management improvement in the CACFP to all State agencies in 1997 and 1998. In the meantime, we continued work on proposed regulations designed to address the problems identified in State and Federal reviews and in audit findings from OIG.

What Was the Legislative Response to the Review and Audit Findings?

The William F. Goodling Child Nutrition Reauthorization Act of 1998 (Pub. L. 105–336, October 31, 1998) earmarked a portion of the CACFP appropriation for Fiscal Years 1999 through 2003 to provide training and technical assistance to State agencies to improve program management and oversight (42 U.S.C. 1766(q)(3)). With this funding, we developed a formal training package that incorporated and expanded upon the written management improvement guidance issued in 1997–1998. In the fall and winter of 1999–2000, we conducted sessions around the country during which over 500 State agency staff involved in various aspects of Program administration received training in these management improvement techniques. We also intensified our efforts to monitor the CACFP in every State in fiscal years 2000 and 2001. We will use the results of these reviews to inform us in developing additional training and guidance on the most problematic aspects of Program operations and administration, and to help us target areas of State-level Program management for more intensive review in the future.

On June 20, 2000, the Agricultural Risk Protection Act of 2000 (Pub. L. 106–224, (ARPA)) was enacted. ARPA made a number of changes to the CACFP statute (section 17 of the Richard B. Russell National School Lunch Act (42 U.S.C. 1766) (NSLA)) designed to improve Program integrity. Shortly after that, the Grain Standards and Warehouse Improvement Act of 2000 (Pub. L. 106–472, November 9, 2000) (Grain Standards Act) modified one of the amendments made by ARPA. The ARPA and Grain Standards Act amendments are the basis for this rule and are discussed in more detail below.

Why Is the Department Publishing These Changes in an Interim Rule?

We are publishing this as an interim rule because of the requirements of ARPA. Section 263(a) of ARPA required

the Secretary to publish rules as soon as practicable without regard to the notice and comment requirements of section 553 of the Administrative Procedure Act, the Secretary of Agriculture's policies relating to public participation in rulemaking, and the Paperwork Reduction Act. Therefore, we are required to publish a rule incorporating these changes to CACFP as expeditiously as possible. The amendments made by section 307 of the Grain Standards Act are essential to full implementation of the ARPA provisions and we have thus found that good cause exists to publish those amendments without first taking public comment.

Has the Department Issued Any Guidance on the Amendments Made by ARPA and the Grain Standards Act?

Yes. To help State agencies implement these provisions until a rule could be published, we issued the following items:

- July 20, 2000—''Implementing Statutory Changes to the CACFP Mandated by the Agricultural Risk Protection Act of 2000 (Pub. L. 106–224)''
- October 16, 2000—''Monitoring Requirements for Sponsoring Organizations in the Child and Adult Care Food Program (CACFP)''
- October 17, 2000—Letter to State agency directors on termination of institutions and day care homes
- April 12, 2001—''Effects of the Agricultural Risk Protection Act, Pub. L. 106–224, on termination of the agreements of day care home providers in the CACFP''

These items were sent to all State agencies and are also available on our website at *www.fns.usda.gov/cnd.*

In addition, in December of 2000, we conducted training for all Food and Nutrition Service (FNS) regional staff on the ''suspension'' provisions in the Grain Standards Act.

What Is the Relationship Between This Rule and the Proposed Rule on Improving Management and Program Integrity in CACFP?

Enactment of ARPA meant that some of the provisions that we had originally planned to include in the proposed rulemaking are now mandated by § 17 of the NSLA. As a result of ARPA's enactment, we deleted provisions that we originally intended to include in the proposed rule that was ultimately published on September 12, 2000 (65 FR 55101). The provisions deleted from the proposed rule, as well as other provisions relating to the amendments made by ARPA and the Grain Standards Act, are addressed in this interim rule. After we receive public comment on this interim rule, we will analyze comments on both the proposed and interim rules. We then intend to publish a single rule that implements the provisions of the proposed rule and makes any necessary changes to the provisions being implemented in this interim rule.

Readers should note that in order to make the changes necessary to implement the provisions of ARPA and the Grain Standards Act relating to institution eligibility, we had to reorganize the provisions relating to State agency approval of institution applications in 7 CFR 226.6(b) of the current regulations. We had already proposed to amend several of these provisions in the September 12, 2000, rule (e.g., eliminating the requirements that State agencies notify an institution of an incomplete application within 15 calendar days and that State agencies provide technical assistance to institutions in completing their applications). In order to avoid confusion and to provide us the opportunity to evaluate any comments on these proposed changes, we have not included the proposed changes in this interim rule. Therefore, in making the necessary reorganization of § 226.6(b), we repeated these provisions as they exist in the current rules, and *not* as we proposed changing them in the September 12, 2000, rule.

The same circumstances occurred in other parts of this interim rule as well. For the most part, we have avoided incorporating any of the changes proposed on September 12, 2000, in this rule unless two conditions applied: (a) Commenters on the proposed rule were overwhelmingly in favor of the proposed change; *and* (b) making the change in this rule was essential to implementation of the provisions of ARPA and the Grain Standards Act. Provisions from the proposed rule that have been incorporated in this interim rule are explicitly noted in this preamble.

What Is the Department's Role in Ensuring Proper Implementation of the Many Changes Mandated by This Rule?

We will continue to monitor, and provide technical assistance to, State agencies to assure proper implementation of this rule's provisions. Specific funding for CACFP training and technical assistance is being utilized, in part, to conduct more, and more comprehensive, management evaluations of State agencies' Program administration.

In Fiscal Years 2000–2001, we conducted reviews in every State, and we will continue to conduct intensive monitoring in future years as well. As part of this effort, we revised the CACFP management evaluation guidance used by regional offices in order to ensure that an in-depth evaluation of each State agency's Program administration was conducted. The management evaluation guidance will be further revised to add compliance with the new provisions of this rule as a key element of management evaluations conducted after this rule's publication.

How Is the Remainder of This Preamble Organized?

Because of the overlap between some provisions of the interim and proposed rules, we have organized this preamble into three parts, using approximately the same organization we used in the proposed rule. This organization of the preamble is intended to facilitate the later publication of a single rule both finalizing the provisions of the proposed rule and making any necessary modifications to this interim rule. The preamble is organized as follows:

Part I. Basic Institution Eligibility Criteria, Review and Approval of Institutions' Applications; Serious Deficiency Determinations, Corrective Action, Suspension, Termination, and Disqualification; and Administrative Reviews

A. Basic requirements for institution eligibility
1. Limits on outside employment (§§ 226.6(b)(16) and 226.16(b)(7))
2. Bonding (§§ 226.6(b)(17) and 226.16(b)(4))
3. Tax exempt status (§§ 226.12(b)(2)(i), 226.15(a), 226.17(b)(2), 226.19(b)(2) and 226.19a(b)(4))
4. Past performance (§§ 226.6(b)(12)–(14), 226.15(b), 226.15(b)(7)–(8) and 226.16(b))

B. Standards for State agency review of an institution's application (§ 226.6(b)(18))

C. Additional condition for State agency approval of a new sponsoring organization's application (§§ 226.6(b)(11) 226.6(b)(18)(ii)(A)

D. Serious deficiency determination, corrective action, suspension, termination, and disqualification (§§ 226.2 and 226.6(c))
1. Denial of an application from a new or renewing institution (§§ 226.6(c)(1) and (2))
2. Actions based on serious deficiency determinations (§§ 226.6(c)(1), (c)(2), and (c)(3))
3. Corrective action timeframes (§ 226.6(c)(4))
4. Suspension of participation for an institution (§§ 226.2 and 226.6(c)(5))
5. FNS determination of serious deficiency (§ 226.6(c)(6))
6. National disqualified list (§§ 226.2 and 226.6(c)(7))
7. State agency list (§§ 226.2 and 226.6(c)(8))

Part I. Basic Institution Eligibility Criteria; Review and Approval of Institutions' Applications; Serious Deficiency Determinations, Corrective Action, Suspension, Termination, and Disqualification; and Administrative Reviews

In order to improve Program management in the CACFP, it is critical that an institution (i.e., an independent center or a sponsoring organization of day care homes and/or centers) be required to demonstrate in its Program application that it is capable of administering the Program in accordance with the regulations. Similarly, when an institution participating in the Program is found to have serious management problems and fails to take corrective action within a reasonable period, it has demonstrated that it is not qualified to continue participating. In both cases, State agencies must have clear minimum Federal guidelines for taking action to deny an institution's application or to terminate the institution's Program participation. Part I of this preamble discusses the new ARPA and Grain Standards Act requirements that are intended to improve State agencies' ability to approve or renew only qualified applicant institutions; to restrict or eliminate certain institutional practices deemed problematic by State and Federal reviews and OIG audits; and to terminate institutions' agreements when necessary.

A. Basic Requirements for Institution Eligibility

Prior to ARPA, What Were the Basic Requirements for Institution Eligibility?

The NSLA sets forth certain basic eligibility requirements that institutions must meet prior to their participation in CACFP. Before enactment of ARPA, these were set forth at §§ 17(a) and 17(d) of the NSLA. In addition to requirements specific to different types of institutions, the law stated that no institution was eligible to participate unless it accepted final administrative and financial responsibility for the Program's operation, and had not been seriously deficient in its administration of CACFP or other child nutrition programs.

What Changes Did ARPA Make to These Requirements?

Section 243(a)(8) of ARPA added three new eligibility requirements for sponsoring organizations: (1) Employment of an appropriate number of monitoring staff, based on regulations promulgated by the Department; (2) establishment of a policy that prohibits sponsoring organization employees from having other employment that interferes with their Program responsibilities and duties; and, (3) for *new* sponsoring organizations, compliance with any State law, regulation, or policy requiring them to be bonded. In addition, § 243(b) made two changes to basic eligibility requirements for all institutions by: (1) modifying the tax exempt status provision of the NSLA by eliminating the participation of any private nonprofit institution which has not yet obtained (i.e., is ''moving towards'') tax exempt status; and (2) broadening the requirements for satisfactory past performance by all institutions.

These new eligibility requirements (except for sponsor monitor staffing standards, discussed in Part II of this preamble) are discussed in this section (Part I(A)) of the preamble. Other eligibility criteria pertaining to an institution's viability, capability, and accountability, as well as a special requirement pertaining to new sponsoring organizations, were added to the NSLA by § 243(b) of ARPA and are discussed in Parts I(B) and I(C) of this preamble, respectively.

1. Limits on Outside Employment (§§ 226.6(b)(16) and 226.16(b)(7))

Section 243(a)(8)(D) of ARPA amended § 17(a) [§ 17(a)(6)(E), as amended] of the NSLA to require that all sponsoring organizations have in effect ''a policy that restricts other employment by employees that interferes with the responsibilities and duties of the employees of the organization with respect to the program. * * *'' This requirement was prompted by several OIG audits which uncovered examples of sponsoring organizations' executive directors or other employees who received full-time salaries paid out of CACFP administrative funds while also being employed in a full-time capacity by another organization. This rule adds § 226.6(b)(16), which requires sponsoring organizations not participating as of July 29, 2002 to submit their outside employment policy to the State agency as part of their Program applications, and to have sponsoring organizations participating as of July 29, 2002 submit an outside employment policy to the State agency not later than August 26, 2002. This rule also makes a parallel change to § 226.16(b)(7).

Is the Department Regulating the Content of These Outside Employment Policies?

We will not, except to establish certain broad parameters for State agencies' use in reviewing such policies. Outside employment policies must apply to *all* employees of the sponsoring organization who have responsibilities relating to the operation of CACFP. We acknowledge that these policies do not have to bar sponsoring organization employees from holding second jobs; however, a full-time employee cannot reasonably be expected to perform his/her Program duties while holding a second full-time job. Therefore, in establishing limits on outside employment, such policies should take into account the number of work hours being charged to the CACFP (e.g., is the employee being paid for 8 hours of work per week related to CACFP, or 40?) and the nature of the sponsor-related duties the employee performs which are paid out of CACFP funds. In addition, such policies must specifically restrict any outside employment that constitutes a real or apparent conflict of interest.

2. Bonding (§§ 226.6(b)(17) and 226.16(b)(4))

Section 243(a)(8)(D) of ARPA further amended § 17(a) [§ 17(a)(6)(F), as amended] of the NSLA to require that any new sponsoring organization applying to enter the program obtain a bond if such bond is required ''under State law, regulation, or policy. * * *'' Because ARPA refers to State law, regulation, or policy, it is apparent that States should be accorded broad discretion in this area. However, the law is clear that such bonding requirements

may only be applied to *new* (i.e., those that apply for initial participation on or after the date of enactment of ARPA: June 20, 2000) sponsoring organizations. This provision does not preclude a State agency from requiring an institution to obtain a bond as part of a corrective action plan.

Accordingly, this rule adds §§ 226.6(b)(17) and 226.16(b)(4) to require that sponsoring organizations applying for initial participation in CACFP on or after June 20, 2000, submit a bond if such bond is required by State law, regulation, or policy. In order to analyze this provision's impact, § 226.6(b)(12) also requires that any State agencies with such a requirement provide to the appropriate Food and Nutrition Service regional office (FNSRO) a copy of their State's law, regulation, or policy establishing bonding requirements for new CACFP sponsors, as well as a list of the organizations that have posted a bond as a result of such a requirement.

3. Tax Exempt Status (§§ 226.12(b)(2)(i), 226.15(a), 226.17(b)(2), 226.19(b)(2), and 226.19a(b)(4))

Prior to enactment of ARPA, § 17(d)(1) of the NSLA required that nonprofit institutions have tax exempt status under the Internal Revenue Code of 1986 or, ''under conditions established by the Secretary, [be] moving toward compliance with the requirements for tax exempt status. * * *'' A previous amendment to the NSLA had limited to 180 days the period during which most institutions could participate in CACFP in a ''moving towards tax exempt'' status. However, § 243(b) of ARPA amended § 17(d)(1) [§ 17(d)(1)(B) as amended] to require nonprofit institutions to have tax exempt status under the Internal Revenue Code of 1986 prior to the start of their Program participation.

Accordingly, this rule amends §§ 226.12(b)(2)(i), 226.15(a), 226.17(b)(2), 226.19(b)(2), and 226.19a(b)(4) to require that nonprofit organizations have tax exempt status prior to their participation in CACFP.

4. Past Performance (§§ 226.6(b)(12)–(14), 226.15(b), 226.15(b)(7)–(8), and 226.16(b))

Prior to enactment of ARPA, § 17(a)(2)(B) of the NSLA stated that, in order to be eligible to participate in CACFP, an institution must not have been ''seriously deficient in its operation of the child care food program, or any other'' child nutrition program ''for a period of time specified by the Secretary.'' Section 243(a)(8)(A) of ARPA amended § 17(a)(6)(B) [as amended] by adding that institutions must not have been ''determined to be ineligible to participate in any publicly funded program by reason of violation of the requirements of the program'' for a period of time specified by the Secretary.

Section 243(c) of ARPA also added § 17(d)(5)(B)(i) to the NSLA, which requires us to establish procedures for terminating the participation of an institution or day care home provider that, among other things, conceals a criminal background. This provision indirectly establishes another eligibility requirement with regard to criminal backgrounds.

Why Does This Rule Revise the Requirement Concerning Past Performance in the Child Nutrition Programs?

Currently, the requirement that a State agency may not enter into an agreement with an institution that has been seriously deficient in its operation of the CACFP or any other child nutrition program is contained in § 226.6(c). These institutions are placed on what has been known as the FNS list of ''seriously deficient institutions'' (this list is renamed the National disqualified list by this rule). The institution remains ineligible for the Program until FNS, in consultation with the appropriate State agency, determines that the serious deficiency that resulted in the ineligible status has been corrected.

As discussed further in Part I(D) of the preamble, this rule reorganizes § 226.6(c). As part of this reorganization, we moved the provision that requires State agencies to deny applications from institutions that have been seriously deficient in the CACFP or other child nutrition programs to § 226.6(b). This provision is really a requirement for Program eligibility rather than a basis for a new determination of serious deficiency (that is, if an institution applying to participate was determined to be on the National disqualified list, its application would be denied, but it would not be declared seriously deficient and placed on the list again). As such, it is more properly placed in § 226.6(b), which is the section that addresses application approval. We have also reworded the provision to make it clear that State agencies are prohibited from approving an application submitted by an institution that is on the National disqualified list. This rule also makes clear that State agencies are prohibited from approving an institution's application if any of the institution's principals is on the National disqualified list, and are prohibited from approving the sponsoring organization's application on behalf of a facility if either the facility or any of its principals is on the National disqualified list. These prohibitions are in §§ 226.6(b)(12) and (b)(13) of this rule. Related changes are made by this rule in §§ 226.15(b) and 226.16(b). These changes are necessary to comply with the requirements of ARPA for establishing a National disqualified list that includes disqualified institutions, day care home providers, and individuals.

How Does This Rule Incorporate the Requirement Concerning Past Performance in Other Publicly Funded Programs?

This rule places the new eligibility criterion concerning past performance in other publicly funded programs in § 226.6(b). In order to assist State agencies in evaluating whether an institution is ineligible to participate in any other publicly funded program by reason of violating that program's requirements, this rule adds new §§ 226.6(b)(13) and 226.15(b)(7) that require, as a part of each application, that the institution list all publicly funded programs in which the institution and its principals participated in the past seven years and that the institution certify that neither it nor any of its principals is ineligible to participate in those programs by reason of violation of the requirements of those programs during that period. Instead of such a certification, the institution may submit documentation that the institution or the principal previously determined ineligible was later fully reinstated in, or is now eligible to participate in, the program, including the payment of any debts owed.

What Is the Effect of a Criminal Background?

As noted above, in order to incorporate the ARPA requirement that we establish procedures for terminating the participation of an institution or day care home provider that conceals a criminal background, we must also establish an application eligibility requirement with regard to criminal backgrounds. This rule amends § 226.6(b) to prohibit State agencies from approving an 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. Convictions indicating a lack of business integrity include fraud, antitrust violations, embezzlement, theft, forgery, bribery, falsification or obstruction of justice, or any other activity indicating a lack of

business integrity as defined by the State agency. As with the requirement concerning past performance in other publicly funded programs, the rule adds to new § 226.6(b)(14) a requirement that institutions include with their applications a certification concerning the criminal backgrounds of the institution and its principals. A related amendment is made in § 226.15(b)(8).

Are There Any Other Changes to the Program Application Resulting From These ''Past Performance'' Provisions Mandated by ARPA?

Yes. We have also amended § 226.6(b)(13) and (b)(14) to require that the Program application include, as part of these two certification requirements, language stating that institutions and individuals providing false certifications will be placed on the National disqualified list and will be subject to any other applicable civil or criminal penalties. This language will help to deter the submission of applications by ineligible institutions and individuals, and will also provide the institution and individuals with notice regarding the consequences of submitting false certifications.

Why Did the Department Establish Seven Years as the Period of Time for the Past Performance and Criminal Background Eligibility Criteria?

Prior to this rulemaking, an institution that had its participation terminated as a result of an uncorrected serious deficiency in its operation of any FNS Child Nutrition Program was placed on the National disqualified list. Once on the list, an institution was barred indefinitely from participating in the CACFP. Removal from the list occurred only when FNS, in consultation with a State agency, determined that the original serious deficiency had been corrected. In establishing criteria for participation for this rule, we considered whether an indefinite ban on participation accomplished the goal of ensuring Program integrity. We also considered whether an indefinite ban was a reasonable consequence of serious past performance problems by an individual or organization, and whether it was reasonable for those with a criminal background.

We examined similar regulations providing a bar to participation, the government-wide nonprocurement suspension and debarment provisions, codified for the Department at 7 CFR part 3017. Companies and individuals may be debarred when determined not presently responsible based on actions such as criminal convictions or civil settlement agreements for fraud, antitrust violations, violation of terms of a public contract, and similar acts. Under the debarment regulations, companies and individuals may be debarred—banned—from participating in both procurement and nonprocurement transactions with Federal agencies, grantees and subgrantees, for a period of 3 years and, in some circumstances, 5 years. This suggested that a more time-limited ban on Program participation by an institution would be reasonable under the new regulations for the Program. However, we also concluded that being placed on the CACFP National disqualified list differed from the debarment provisions in impact due to the breadth of a debarment action's effect. While debarment prevents an entity from entering into any transactions with any Federal agency and many grantees and subgrantees, being placed on the CACFP list merely affects participation in FNS Child Nutrition Programs. Debarment's impact is potentially more significant than a ban on participation from a single program or set of programs.

On balance, we established the seven-year ban to underscore the importance of ensuring Program integrity—the fundamental focus for Congress in creating the statutory provisions we are implementing in this rule. At the same time, we wanted to afford individuals and institutions with a ''second chance'' to participate in CACFP following a predictable period of time. We determined that a seven-year period gives institutions terminated from Program participation an opportunity to correct deficiencies and re-apply for Program participation. Within seven years, institutions interested in reapplication could re-pay Federal funds, institute fiscal and food service changes, retain and train sufficient staff, and establish a proven record of business integrity. This rule establishes a seven-year period for both the past performance and criminal background eligibility criteria. (Note: Placement on, and removal from, the National Disqualified list is discussed in Part I(C)(6) of this preamble, below.

Will State Agencies Routinely Be Required To Research the Past Performance of Institutions in Other Publicly Funded Programs, or To Perform Criminal Background Checks?

No. State agencies may rely on the institution's certification as to its participation in publicly funded programs and its criminal convictions, and the participation in publicly funded programs and criminal convictions of its principals. Although State agencies are not required to conduct background checks or otherwise investigate the past performance of institutions and their principals, nothing in this rule prohibits such efforts. Further, if a State agency has reason to believe that the institution or one of its principals may have been determined ineligible for a publicly funded program, § 226.6(b)(13)(iii) requires the State agency to follow up with the entity administering the publicly funded program to gather additional information. Also, if a State agency later discovers that either certification made by the institution is false, the State agency must declare the institution seriously deficient for providing false information on its application (see §§ 226.6(c)(1)(ii)(A), 226.6(c)(2)(ii)(A), and 226.6(c)(3)(ii)(A), which are discussed in more detail in Part I(D) of the preamble).

B. Standards for State Agency Review of an Institution's Application (§ 226.6(b)(18))

Prior to ARPA, What Other Criteria Did Institutions Need To Meet in Order To Be Approved for Program Participation?

The statutory language mentioned in Part I(A) of this preamble, above (that no institution was eligible to participate in the Program unless it ''accepts final administrative and financial responsibility for management of an effective food service. * * *'') required State agencies to analyze each institution's administrative and financial capability to successfully operate the CACFP. The Program regulations at §§ 226.6(b), 226.6(f)(3), 226.7(g) and 226.15(b)(3) pertaining to the content and review of the budgets annually submitted by all institutions, and at §§ 226.6(b)(5) and 226.6(f)(2) pertaining to the management plans submitted by all sponsoring organizations, provided the bases for State agencies to make this determination of financial and administrative capability.

How Did ARPA Modify the Requirements for State Agency Assessment of an Institution's ''Administrative and Financial Capability''?

The results of recent reviews and audits suggest that the existing criteria for application review have not provided specific enough guidance to State agencies for their use in determining whether an institution's application demonstrates its capability to administer the Program in accordance with the regulations. To that end, ARPA made changes designed to reinforce the

Management Improvement Training FNS provided to State agencies on how they must review a Program application in order to assess an institution's qualifications to operate the CACFP.

Section 243(b)(1) of ARPA amended § 17(d) of the NSLA by requiring that all institutions demonstrate that they meet three broad criteria documenting their ability to operate the Program. These criteria, which must be documented in the Program application, are that ''the institution—

(i) is financially viable;

(ii) is administratively capable of operating the program (including whether the sponsoring organization has business experience and management plans appropriate to operate the program) described in the application of the institution; and

(iii) has internal controls in effect to ensure program accountability.''

State agency staff will recognize these as the same criteria—viability, capability, and accountability (or ''VCA'')—that were described in the Management Improvement Training FNS provided to them during the fall and winter of 1999–2000.

In Light of ARPA's Addition of These Criteria to the Law, How Are You Changing the Requirements for State Agency Review of Institution Applications?

The existing application process does not always provide State agencies with a clear enough way of determining whether an institution meets the law's VCA criteria. Current regulatory requirements at § 226.6(b), which only list the minimum information that must be included in an application, may have inadvertently encouraged some State agencies to adopt a ''checklist approach'' to application review. Such an approach stressed checking to ensure that all of the required components were in the application, but did not always result in a critical analysis of the content of some vital parts of the application, especially the budget and (for sponsoring organizations) the management plan.

In order to implement ARPA's intent that only institutions which have VCA be approved for participation, this interim rule requires at § 226.6(b)(18) that all institutions demonstrate in their applications that they will meet, or are meeting, the three ''performance standards'' addressed in FNS's Management Improvement Training and added to the law. New institutions with no recent record of CACFP performance would be required to show that they have management systems in place and business/management experience which would enable them to operate in accordance with the performance standards. Renewing institutions would be required—through their application and through the most recent State evaluation of their Program operations—to continue to operate in conformance with the performance standards. The definitions of ''new'' and ''renewing'' institutions which were proposed in the rule published on September 12, 2000 (65 FR 55101) are promulgated in this rule to facilitate implementation of these ARPA requirements.

What Are ''Performance Standards'', and How Will They Improve the Application Review Process?

Recently-completed reviews and audits of CACFP institutions have demonstrated conclusively that the mere submission of certain documents with the application provides little assurance that an applicant is capable of administering the Program in accordance with regulations. The requirement to measure the application's content against specific, performance-based measurements (''performance standards'') should change the focus of the State agency's application review process from checking to see that certain documents have been submitted to evaluating the applicant's understanding and ability to implement the Program's requirements, based on the substantive information contained in those documents.

For example, institutions are currently required to submit an administrative budget with their applications. A ''performance standard'' which states that all items in the budget must conform to government-wide, Departmental, and Program-specific financial management requirements emphasizes, both to institutions and to State agency budget reviewers, that each item of cost in the budget must be reasonable, necessary and allowable, and that the budget as a whole must demonstrate that the applicant will devote sufficient resources to ensure the proper, efficient, and effective management of the Program.

What Are the Three ''Performance Standards'', and How Do They Relate to the Process of Establishing in the Application That Each Institution Is ''Viable, Capable, and Accountable''?

These three standards are based on the NSLA's requirement that only institutions which have VCA may participate. The standards—which differ slightly according to whether the institution is a sponsor of day care homes and/or centers, or is an independent center—are designed to help a State agency to measure an institution's potential ability to deliver the Program's benefits to children in accordance with generally accepted business practices and all applicable regulations and guidance. We wish to emphasize that these standards do not replace existing regulatory requirements on institutions' applications; rather, they supplement these requirements and provide State agencies with a better means of fully evaluating an institution's ability to participate in CACFP in accordance with Program regulations.

First Standard: Financial Viability/ Financial Management

The first standard for evaluating an institution's application measures whether it is financially viable, and whether it will expend and account for funds according to financial management requirements set forth in Program regulations, the Department's Uniform Financial Management Requirements (7 CFR parts 3015 and 3016), and FNS Instruction 796–2, ''Financial Management—Child and Adult Care Food Program.'' This rule requires State agencies to evaluate institutions' applications as to whether:

(1) A new sponsoring organization has documented in its management plan that there is a need for its services. This means 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)(11) of this section. All sponsoring organizations must demonstrate that they will use appropriate practices for recruiting facilities, consistent with paragraph (p) of this section and any State agency requirements;

(2) The institution has adequate financial resources to operate the Program on a daily basis, based on Program administrative earnings and non-Program resources (if any) the institution plans to devote to Program administration, and can document financial viability (e.g., through audits and financial statements); and

(3) Costs in the institution's budget are necessary, reasonable, allowable, and properly documented.

The determination of whether the institution is ''financially viable'' will be based upon its budget (and, for a sponsoring organization, its management plan), and will vary based on the size of the institution, the number of facilities it proposes to serve, the number of staff it needs to carry out all Program responsibilities, and the non-CACFP resources (if any) to be used

in the organization's operation of the CACFP.

With regard to recruitment practices, readers should note that this standard will require State agencies to review the facility recruitment practices of any sponsoring organization, whether it administers the Program only in homes, only in centers, or in both homes and centers. Although sponsors of centers rarely recruit new facilities in the same manner, or with the same rapidity, as sponsors of day care homes, the results of some of the OIG audits have led us to re-examine the recruitment practices utilized by some center sponsors. Therefore, if a sponsor proposes to recruit child care or adult day care centers, this rule requires State agencies to apply the recruitment element to them as well.

With regard to the recruitment of day care homes by a sponsoring organization already participating in CACFP, we wish to emphasize that ''appropriate recruitment practices'' are those designed to add non-participating day care homes to the Program, not those that are designed to encourage participating homes to change sponsorships. From time to time, some day care home providers may wish to change sponsors for valid reasons. However, a sponsoring organization's costs related to marketing their sponsorship to providers already participating in CACFP under another sponsorship are not allowable Program costs, under the ''reasonable and necessary'' requirements of government-wide cost principles and FNS Instruction 796–2, ''Financial Management—Child and Adult Care Food Program.'' We also wish to remind State agencies that they must ensure that a non-participating provider understands that it may choose among approved sponsors if more than one sponsor serves the area of the State in which the provider resides.

Second Standard: Administrative Capability

The second standard for evaluating an institution's application measures whether it is administratively capable and can effectively manage the Program. Appropriate and effective management practices must be in effect to ensure that the Program operates in accordance with regulations. State agencies will review all institutions' applications to determine whether, once they are operating the CACFP, they:

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

(2) If a sponsoring organization, document in their management plan that they employ staff sufficient to meet the ratio of monitors to facilities set forth in § 226.16(b)(1) and the factors established by the State agency pursuant to § 226.6(f)(2); and

(3) If a sponsoring organization, have written policies and procedures that assign Program responsibilities and that ensure compliance with civil rights and other Program requirements.

Third Standard: Program Accountability

The third standard requires the State agency to review the application of any institution to determine that the institution can ensure the accountability of Program funds, as well as the nutritional adequacy of the Program meal service. To this end, all institutions will be required to document that:

- There is adequate oversight of the Program by the institution's governing board of directors;
- There is a financial management system in place with management controls specified in writing;
- Program records are maintained that are sufficient to document compliance with Program requirements, including budgets, approved budget amendments, and audited financial statements; and
- They will follow practices that result in the operation of the Program in accordance with the meal service, recordkeeping, and other requirements of this part.

In addition, when the institution is a sponsoring organization, the State agency will also review the sponsoring organization's management plan to determine whether the sponsoring organization:

(1) Maintains on file valid and complete facility applications and other appropriate records of provider operations;

(2) Will adequately train sponsoring organization and facilities in proper operation of the Program;

(3) Will monitor each facility's compliance with Program requirements at § 226.16(d)(4);

(4) If a sponsor of day care homes, will correctly classify tier I and tier II day care homes;

(5) Has a financial system and management controls specified in writing that assure fiscal integrity and accountability for all funds and property received, held, and disbursed; assure the integrity and accountability of all expenses incurred; assure that funds and property are used, and expenses incurred, for authorized Program purposes; describe a system of safeguards and controls in place to prevent and detect improper financial activities by sponsoring organization employees; and ensure the timely and accurate payment of claims to all sponsored facilities; and

(6) Has a system that assures that sponsored facilities will comply with the Program meal pattern, licensure/approval, civil rights, claims, and recordkeeping requirements.

The third standard primarily measures whether the applications of independent centers and sponsoring organizations assure that they will accountably and appropriately operate the Program to provide nutritious meals to participants and meet all other Program requirements.

Will the Department Provide More Detailed Descriptions of the Individual Elements of the Three Performance Standards in This Proposal?

No. Including detailed guidance in this rulemaking would make the preamble and regulatory language too cumbersome. Additionally, we could not take into account all of the State-level factors that will affect implementation. Instead, we have presented guidance to State Program administrators in the Management Improvement Guidance issued in 1997–1998 and the training conducted during the fall and winter of 1999–2000. In addition, we will continue to issue Program guidance, and to provide management improvement training, to State agencies on an ongoing basis. State agencies, in turn, are also required to disseminate this written guidance to their institutions, and to train institutions on management improvement regulations and guidance as quickly as possible.

An exception to the statement that we will not provide detailed explanations of the standards in this rule relates to the establishment of sponsor staffing standards for monitoring. Such staffing standards were recommended in the OIG audits and are now statutorily mandated as a result of ARPA. The rationale for these standards is discussed in greater detail in Part II(B) of this preamble, below; the new regulatory requirement appears in § 226.16(d) on sponsors' monitoring responsibilities, and is only cross-referenced in the second performance standard.

What if an Institution's Application Does Not Demonstrate That It Will Meet These Performance Standards?

Unless the State agency determines that an institution has demonstrated its ability to fully meet each of these

standards, the institution's application must be denied and the institution must have the opportunity to request an administrative review of the denial, as specified in § 226.6(k). This new language strengthens the Program's long-standing requirement that, prior to approving an institution for Program participation, the State agency must make a positive determination that the institution's application demonstrates its ability to properly manage and operate the Program.

Accordingly, to provide greater assurance that State agencies approve only those institutions which are capable of operating CACFP in accordance with the regulations, we are revising §§ 226.2, 226.6(b), 226.15(b) and 226.16(b) to:

- Add definitions of ''new'' and ''renewing'' institutions;
- Require that all participating institutions meet the VCA criteria by demonstrating in their Program applications that they comply with the three performance standards discussed above;
- Require that State agencies evaluate all applicant institutions against these performance standards, in order to assess their qualifications to administer the Program properly, efficiently, and effectively; and
- Require that State agencies deny the application of any institution which fails to demonstrate that they meet the performance standards and the other application requirements set forth in § 226.6(b).

C. Additional Condition for State Agency Approval of a New Sponsoring Organization's Application (§§ 226.6(b)(11) and 226.6(b)(18)(ii)(A))

In addition to the application approval criteria embodied in the three performance standards described in Part I(B) of the preamble above, the law establishes an additional condition for the approval of a new sponsoring organization's application to participate in CACFP. Section 243(b)(1) of ARPA further amended § 17(d) [§ 17(d)(1)(C)(i)(II), as amended] of the NSLA by mandating that a State agency may approve a new sponsoring organization's application ''only if the State agency determines that * * * the participation of the institution will help to ensure the delivery of benefits to otherwise unserved family or group day care homes or centers or to unserved children in an area.'' This section of ARPA also requires each State agency to establish criteria to determine whether a new sponsoring organization's participation ''will help to ensure the delivery of benefits to otherwise unserved'' facilities or children.

This provision of ARPA requires a new sponsor to demonstrate to the State agency's satisfaction that it will make CACFP available to currently-unserved facilities or children. It addresses a concern frequently expressed by State agencies and participating sponsoring organizations—that, prior to ARPA, no clear legal basis existed for a State to prohibit a new sponsoring organization from entering CACFP by recruiting an existing sponsor's facilities, sometimes by promising lax enforcement of Program rules.

With regard to the law's requirement that each State agency establish criteria for determining whether a new sponsor will provide benefits to unserved facilities and/or children, the statute implicitly recognizes the possibility of some variation among States' criteria. At the same time, we remind State agencies that, in developing these criteria, they must abide by the law's intent that such criteria apply to new sponsoring organizations only (either sponsoring organizations applying for the first time or applying after a lapse in participation). Additionally, State agencies must understand that the criteria they develop to implement the statutory language regarding unserved facilities and/or children must be administered consistent with current Program rules providing new day care home sponsoring organizations with access to startup funding.

Any State agency requirement that a new sponsoring organization must have a minimum number of homes is contrary to the law. We fully understand that a new sponsoring organization with no financial resources other than CACFP administrative funding will need to sponsor enough homes to generate reimbursement that supports the hiring of staff and the purchase or rental of equipment necessary to successfully operate the Program. However, multi-purpose organizations that have other sources of funding may be willing to use some of these funds to pay for CACFP costs in excess of reimbursements in order to provide the Program's benefits to a small number of homes in an unserved area or areas.

Accordingly, this rule further amends revised § 226.6(b)(11) to require State agencies to develop criteria for determining whether a new sponsoring organization's participation will help ensure the delivery of benefits to otherwise unserved facilities or participants. For the sake of consistency and simplicity, we made clear that this requirement applies to both sponsors of child care facilities and adult day care centers. This rule requires State agencies to disseminate the criteria to new sponsoring organizations when they request information about applying to the Program and requires new sponsoring organizations to submit documentation that they meet the State agency's criteria. This rule also makes this requirement part of Performance Standard 1 (§ 226.6(b)(18)(i)(A)).

D. Serious Deficiency Determination, Corrective Action, Suspension, Termination, and Disqualification (§§ 226.2 and 226.6(c))

What Impact Did ARPA and the Grain Standards Act Have on the Process of Terminating an Institution's CACFP Agreement?

ARPA added provisions to the NSLA that for the first time set statutory standards for the process of suspending the participation of institutions and terminating the agreements of institutions and day care home providers. Shortly thereafter, the Grain Standards Act amended those provisions. ARPA also added new requirements concerning the timing of administrative reviews relating to terminations and suspensions and the availability of administrative reviews for day care home providers in certain cases. As a result of the statutory requirements pertaining to termination, we had to revise the rules governing the entire process leading up to a possible termination—determining an institution ''seriously deficient,'' providing an opportunity to take corrective action, and determining whether the deficiency is satisfactorily corrected.

What Changes Do ARPA and the Grain Standards Act Require?

Section 243(c) of ARPA added a new § 17(d)(5) to the NSLA that requires us to ''establish procedures for the termination of participation by institutions and family or group day care home providers under the program.'' Section 17(d)(5) (as further amended by § 307(c) of the Grain Standards Act) sets forth certain parameters for these procedures. Specifically, the procedures must:

- Include standards for terminating the participation of an institution or day care home provider that ''engages in unlawful practices, falsifies information provided to the State agency, or conceals a criminal background'' or that ''substantially fails to fulfill the terms of its agreement with the State agency'';
- Allow an institution or day care home provider to have an opportunity to take corrective action prior to commencement of termination

procedures, except if the institution or day care home provider engages in practices that pose an imminent threat to participants' health or safety or to the public health or safety, as discussed in Part I(D)(4) below;

- Provide for the suspension of an institution's Program participation if the State agency determines that the institution has submitted ''false or fraudulent claims'' and if a suspension review determines that the ''preponderance of the evidence'' supports the State agency's determination;
- Provide an institution or day care home provider with an administrative review ''prior to any determination to terminate'' an institution's or day care home's agreement; and
- Include the Department's maintenance of a National list of ''institutions, sponsored family or group day care homes, and individuals that have been terminated or otherwise disqualified from participation in the program * * *'' and dissemination of the list to State agencies for use in approving applications for participation.

The changes related to the serious deficiency determination, corrective action, suspension, termination, and disqualification of institutions and responsible principals and responsible individuals are discussed in this part of the preamble (Part I(D)). Part I(D) also discusses FNS determinations of serious deficiency, the National disqualified list, and related State agency lists. Revisions to the administrative review procedures for institutions are addressed in Part I(E) of this preamble, and provisions relating to the disqualification of day care homes and administrative reviews for day care homes follow in Part III(F).

How Does This Rule Amend the Current Regulations at § 226.6(c) To Include These Required Procedures?

The current regulations at § 226.6(c)(1)–(11) list some of the reasons for denying applications and for terminating institutions' agreements as a result of their failure to correct serious deficiencies. The regulations at § 226.6(c) also establish the procedures to be used in denying applications or terminating agreements with institutions.

Over the past several years, based on input from State agencies, we have considered reorganizing and clarifying the regulations dealing with serious deficiencies, corrective action, the termination of CACFP institutions' agreements, and the placement of institutions and individuals on the National disqualified list. The changes to termination procedures mandated by ARPA and the Grain Standards Act, and ARPA's requirement that we develop procedures for all aspects of the serious deficiency/corrective action/termination process, provided us with the opportunity for such a reorganization and clarification.

How Does This Rule Reorganize § 226.6(c)?

The steps that must be followed to deny the application of a new institution, to deny the application of a renewing institution, and to terminate the participation of a participating institution differ. For example, the actions that lead to a serious deficiency determination for a new institution (i.e., an institution applying to participate in the Program for the first time, or after a lapse in participation) are different than for a participating institution. In addition, different procedures must be followed when a State agency takes action to determine an institution seriously deficient versus when FNS takes such an action. In order to accommodate these differences, this rule reorganizes § 226.6(c) as follows:

- § 226.6(c)(1)—Denial of a new institution's application
- § 226.6(c)(2)—Denial of a renewing institution's application
- § 226.6(c)(3)—Termination of a participating institution's agreement
- § 226.6(c)(4)—Corrective action timeframes
- § 226.6(c)(5)—Suspension of participation for an institution
- § 226.6(c)(6)—FNS determination of serious deficiency
- § 226.6(c)(7)—National disqualified list
- § 226.6(c)(8)—State agency list

In an effort to simplify the process, each part of revised § 226.6 provides step-by-step instructions that the State agency must follow in order to take the specified action. As a result, this section of the preamble does not repeat these detailed instructions. Instead, the preamble focuses on the issues that raise unusual questions and the reasons for taking a particular approach to different types of actions. In order to best understand these new provisions, we urge readers to carefully read the new § 226.6(c) before reading this part of the preamble.

1. Denial of an Application From a New or Renewing Institution (§§ 226.6(c)(1) and (2))

What Is the Difference Between a New and Renewing Institution?

This rule amends § 226.2 to add definitions of ''new institution'' and ''renewing institution.'' New institutions are those applying to participate in the Program for the first time or applying after a lapse in Program participation. These definitions enable us to distinguish between the three groups of institutions (''new institutions,'' ''renewing institutions,'' and ''participating institutions'') as we discuss the standards for approving and denying Program applications and terminating Program agreements. These definitions were included in the proposed integrity rule and received widespread commenter support.

When Must a State Agency Deny the Application of a New or Renewing Institution?

The current wording and organization of § 226.6(c) is somewhat unclear with regard to the process for denying applications. For example, because this paragraph deals with both the denial of an institution's application and with the termination of the agreement of a participating institution, some State agencies may have been deterred from denying the application of an institution that failed to demonstrate the ability to operate the Program, because they may have believed that they were required to first determine that the institution was ''seriously deficient''.

State agency administrators are aware that, if a new institution applies to CACFP and is determined unqualified to participate (e.g., it is found to lack the financial and administrative capability to operate the Program), it does not mean that the institution is ''seriously deficient'' in the same sense that a currently participating institution is ''seriously deficient'' when it is found to have mismanaged the Program or misappropriated Program funds. Rather, it may be the case that, by hiring more or better qualified staff or by improving its management plan in other ways, a new institution could subsequently be approved for participation. Thus, new institutions whose applications to participate are denied should not normally be determined seriously deficient and placed on the National disqualified list. Being placed on the National disqualified list would prohibit them from participating in CACFP until they were removed from the list. In fact, an assumption that a new institution whose application is denied will normally be placed on the National disqualified list could deter institutions from applying to participate and State agencies from denying applications, because the consequence of disapproving the application (placement on the National disqualified list) would be so severe.

This rule makes clear in §§ 226.6(c)(1)(i) and 226.6(c)(2)(i) that the State agency must deny the applications of new and renewing institutions if the applications do not meet *all* of the requirements for Program applications in §§ 226.6(b), 226.15(b) and 226.16(b). Only if, in reviewing the application, the State agency determines that the institution has committed one or more serious deficiency as identified in §§ 226.6(c)(1)(ii) and 226.6(c)(2)(ii), must the State agency initiate action to disqualify the institution and the principals and individuals responsible for the serious deficiency(ies).

What Action Must the State Agency Take if It Determines a New Institution Is Not Capable of Meeting the Performance Standards?

If the State agency determines that a new institution is not capable of meeting the performance standards, the State agency must deny the application without making a serious deficiency determination.

How Does This Differ From a State Agency's Determination That a Renewing Institution Is Not Meeting the Performance Standards?

The result for a renewing institution is different from that of a new institution. Normally, we would expect that a State agency would discover that a participating institution is not operating in conformance with the performance standards during a review. In that case, the State agency must take immediate action to initiate a process that could ultimately lead to the termination of the institution's agreement, including declaration of serious deficiency and the opportunity to take corrective action. However, on occasion a State agency might not detect such a failure until a renewing institution submits its application. Again, the State agency must initiate action to deny the renewal application, including declaration of serious deficiency and the opportunity to take corrective action.

2. Actions Based on Serious Deficiency Determinations (§§ 226.6(c)(1), (c)(2), and (c)(3))

What Do You Mean by ''Seriously Deficient'' and ''Disqualified'?

We believe that the terminology used in current regulations may have confused some State agency Program administrators and contributed to errors in responding to institutions with serious operational problems. For example, in current regulations, the phrases ''serious deficiency'' and ''seriously deficient institution'' are used to refer to institutions at two very different stages of a process: initially, an institution is notified by its State agency that it is ''seriously deficient'' in its operation of CACFP and is given an opportunity to take corrective action; later, if the institution fails to take corrective action during the specified time, its agreement is terminated by the State agency and it is placed on a list of ''seriously deficient institutions.'' Thus, in the current regulations, ''seriously deficient'' is used to describe institutions that have been told by the State agency that they have a serious management problem, and also to describe institutions that have failed to correct such a problem and whose Program agreements have been terminated.

ARPA uses the term ''disqualified'' to refer to institutions that were determined to be seriously deficient, failed to take corrective action, and whose agreements were terminated after completion of an administrative review (appeal), or when no review was requested. This rule adopts this terminology and amends § 226.2 to add definitions of ''seriously deficient'' and ''disqualified.'' This allows us to distinguish, more clearly than in the current regulations, between (1) those ''seriously deficient'' institutions that have been informed of a serious deficiency and will have an opportunity to correct the deficiency and (2) those ''disqualified'' institutions that have failed to take satisfactory corrective action within the allotted period of time, have had their Program agreement terminated, and have been placed on the National disqualified list.

What Is the Difference Between an Institution Making Administrative Errors, and an Institution that Is Seriously Deficient?

It is critical to discuss the circumstances warranting a determination of serious deficiency. To understand how and when a determination of serious deficiency must be issued, State agencies must be able to distinguish between administrative errors and ''serious deficiencies'' because, once an institution is determined to be seriously deficient, the process can culminate in only two outcomes: the correction of the serious deficiency to the State agency's satisfaction within stated timeframes, or the State agency's proposed termination of the institution's agreement.

In monitoring institutions, State agencies routinely discover management problems that warrant various types of responses. If, for example, the State agency discovers that child care facilities are serving meals that meet the Program's meal pattern but lack variety, we anticipate that the State agency would suggest ways for the sponsor to help facilities have greater variety in their menus. Similarly, if a State agency discovered that the institution made occasional recordkeeping errors, it would require correction of the procedures giving rise to these errors, or additional training of the staff making the errors. Neither of these examples would warrant determining the institution seriously deficient.

There is, however, a point at which institutions experiencing continued problems of this sort indicate serious mismanagement and therefore a serious deficiency. Problems that initially appear manageable may become serious deficiencies if not corrected within a reasonable period of time.

Is There Any Room for the Exercise of Discretion by the State Agency in Deciding Whether an Institution Is Seriously Deficient?

Yes. As discussed above, a State agency should differentiate between occasional administrative errors and systemic management problems. A single instance of some of the actions listed as serious deficiencies in this rule (for example, the misclassification of several tier II homes when the sponsor administers 500 or 1,000 homes) would not be a basis for a determination of serious deficiency, whereas a single occurrence of other actions (for example, submission of a false claim) would be. A sponsoring organization of day care homes that misclassifies two of its 1,000 homes as tier I due to clerical errors must be viewed differently than a sponsor with widespread misclassification due to fundamental errors in the organization's operation of tiering or due to its improper use of school, census, or household income data. Similarly, a sponsor that fails to pay two of its 1,000 providers on a timely basis due to a clerical error must be treated differently than a sponsor that fails to pay a significant number of its providers within five days, as required by the regulations, or is found to have used provider reimbursements to pay for administrative expenses. Thus, a State agency must consider both the type and the magnitude of the problem when deciding whether it warrants determining the institution to be seriously deficient. Similarly, as discussed in the previous portion of this preamble, when reviewing an incomplete renewal application, a State agency would generally request the submission of more or better information to complete the application

or to demonstrate that the institution was viable, capable, and accountable. If the renewing institution proved unable to document its compliance with one or more aspect of the performance standards, then the State agency would make a determination that the institution is seriously deficient.

We recognize that State agencies may encounter examples that are not readily identifiable as either ''administrative errors'' or ''serious deficiencies.'' We urge State agencies with questions regarding the proper application of these concepts to consult their FNSROs for technical assistance.

Why Are the Lists of Serious Deficiencies Not Identical for These Three Types of Action?

In order to simplify and clarify the serious deficiency process, this rule establishes separate lists of serious deficiencies applicable to new institutions (§ 226.6(c)(1)(ii)), renewing institutions (§ 226.6(c)(2)(ii)), and participating institutions (§ 226.6(c)(3)(ii).

The current list of serious deficiencies at § 226.6(c) forms the basis for the list of serious deficiencies for participating institutions. This rule revises the existing language to expand and clarify the types of problems that would lead a State agency to determine an institution seriously deficient in order to fully meet our responsibilities under ARPA. The changes for participating institutions are at § 226.6(c)(3)(ii) and include as serious deficiencies:

- Failure to properly implement and administer the day care home termination and administrative review procedures set forth at §§ 226.6(l) and 226.16(l);
- Use of provider funds to pay the sponsoring organization's administrative expenses;
- Failure to comply with the performance standards at § 226.6(b)(14);
- Failure to repay disallowed expansion funds to the State agency;
- Failure to correctly classify day care homes as tier I or tier II;
- Failure to properly train or monitor sponsored facilities;
- Failure to pay sponsored facilities in accordance with the regulations;
- The fact that the institution or any of the institution's 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 is now eligible to participate in, that program, including the payment of any debts owed); and
- Conviction for 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.

The additional items reflect changes in the CACFP regulations and underscore the importance of particular management functions, the failure or nonperformance of which reviews and audits have identified as common problems among institutions whose participation was ultimately terminated for mismanagement. In addition, the final two items reflect statutory changes to the NSLA resulting from the ARPA. We wish to emphasize that State agencies must not attempt to review another public entity's decision to terminate or declare ineligible an institution from a publicly funded program for violating that program's requirements. Similarly, State agencies must not review a court's action in convicting an institution or its principals of a business-related offense. The NSLA's intent in this area is to require the CACFP State agency to initiate action to terminate an institution's participation based on a final determination made by another public entity or a court.

Are There Any Serious Deficiencies That Are Not Included in the Lists?

This rule clarifies that the list of serious deficiencies for all three categories of institutions is *not* meant to be all-inclusive. Any problem that results in, or otherwise demonstrates, an institution's failure to perform its administrative or financial responsibilities under the regulations, requires a State agency to determine the institution seriously deficient. Thus, the final item in the list of serious deficiencies for all three types of institutions (''any other action affecting the institution's ability to administer the Program in accordance with Program requirements'') is intended to provide State agencies with the ability to declare an institution seriously deficient when the institution engages in action that rises to the level of a serious deficiency, but is not specifically enumerated in the applicable list of serious deficiencies for new, renewing, or participating institutions.

May an Individual Be Determined To Be Seriously Deficient?

No. Only institutions may be determined to be seriously deficient and given the opportunity to take corrective action. In most cases, an institution's completion of successful corrective action would cause a State agency to rescind the declaration of serious deficiency against the institution and discontinue any potential action that might be taken to place responsible principals or responsible individuals on the National disqualified list.

However, ARPA requires us to maintain a list of institutions, day care home providers, and individuals (i.e., responsible principals and responsible individuals, as defined in the preamble, below) that have been terminated or otherwise disqualified from Program participation. It has long been our practice to include institutions and individuals on the ''serious deficiency'' list. This step is necessary to recognize that the individuals responsible for the serious deficiencies in one corporation may, if not disqualified, simply form a new corporation in order to return to the Program.

In addition, there are circumstances under which an institution might correct its serious deficiencies while an individual employee might not. This is why the rule permits State agencies to specify different corrective action for the institution and for the responsible principals or responsible individuals. For example, an institution in which the accountant has embezzled Program funds might take corrective action by removing the accountant from his position and re-paying Program funds; depending on the circumstances of the embezzlement, that action and action to amend the institution's internal fiscal controls might constitute adequate corrective action for the institution. However, the accountant's corrective action would necessarily involve repayment of the embezzled funds to the institution, so that the institution could re-pay the State agency. If the embezzled funds were not repaid, the State agency would continue to pursue disqualification of the accountant, so that he/she would be placed on the National disqualified list and be barred from participating in CACFP until the accountant completed corrective action (i.e., has repaid the funds owed under the Program).

What Is a ''Responsible Principal or Responsible Individual''?

To address these situations and to comply with the ARPA requirements, this rule amends § 226.2 to define

''responsible principal or responsible individual'' as a principal or other individual employed by or under contract with an institution, or an uncompensated individual, who is determined to have responsibility for an institution's serious deficiency. Responsible principals and responsible individuals must be identified in the notice of serious deficiency, must receive a copy of the notice of serious deficiency, and must be provided an opportunity for an administrative review of their proposed disqualification (if adequate corrective action has not been taken by the institution and/or the individual). Part I(E) of the preamble discusses the special procedures for administrative review of the proposed disqualification of responsible principals and responsible individuals.

What Is the Effect of Determining That a New Institution Is Seriously Deficient, Considering That the Institution Had Not Yet Entered Into an Agreement With the State Agency?

As noted above, a State agency would determine that a new institution is seriously deficient only in rare circumstances, such as the submission of false information on its application. In such a case, the outcome of this process (if the new institution failed to correct the serious deficiency) is denial of the application and disqualification of the institution and the principal(s) and individual(s) responsible for the serious deficiency (unless the institution prevailed in an administrative review). Disqualification prevents these parties from participating in the Program as part of a different corporation or in a different State.

Also, a new institution may not participate in the Program pending completion of an administrative review of its proposed disqualification. ARPA's requirement that, under most circumstances (see Part I(E) below for further discussion), institutions be permitted to participate pending completion of their administrative review does not apply because the new institution was not participating in the Program at the time of the denial of its application.

What Happens if the State Agency Determines That a New Institution Has Successfully Corrected the Serious Deficiency?

If the State agency determines that the institution has taken corrective action to fully and permanently correct the serious deficiency, the State agency must offer the institution an opportunity to resubmit its application. The State agency must complete its review of the application within 30 days of receiving a complete application. We expect that in most cases the review of a resubmitted application would be faster than 30 days given that the State agency will have already made a preliminary review of the application.

What if the State Agency Determines That a Renewing Institution's Corrective Action Is Inadequate Just Before the Institution's Existing Agreement Expires? Couldn't the State Agency Simply Allow the Existing Agreement To Expire, Regardless of Whether the Institution Chooses To Pursue an Administrative Review?

No. To allow the existing agreement with a renewing institution to expire would not be consistent with the ARPA requirement that an institution have the opportunity for an administrative review prior to the termination of its agreement, nor would it be consistent with the statute's intent that, once an institution is declared seriously deficient, it must either correct the deficiency or be terminated and placed on the National Disqualified list. Thus, this rule requires the State agency to provide a short-term extension of the existing agreement, pending the outcome of the administrative review. If the administrative review official rules in favor of the State agency, the State agency must then deny the renewal application, terminate the extended agreement, and disqualify the institution and the responsible principals and responsible individuals.

In Effect, Doesn't This Mean That the State Agency's Denial of an Application From a Renewing Institution Has No Effect on the Institution's Participation, Pending the Outcome of Its Administrative Review?

That is correct. Denial of the renewal application has no impact on the institution's participation in CACFP until either (1) the time allotted for the institution to request an administrative review expires without the institution requesting an administrative review or (2) the administrative review official rules in favor of the State agency, at which time the extended agreement must be terminated. This approach provides consistency with the treatment of participating institutions determined to be seriously deficiency mid-agreement. It also may discourage a State agency from inappropriately waiting to deny the application of a renewing institution instead of taking earlier action to terminate the institution's agreement based on a serious deficiency.

If an Institution Terminates Its Agreement After Being Determined Seriously Deficient, What Action Must a State Agency Take?

Occasionally, after being notified that it is seriously deficient, an institution terminates its CACFP agreement voluntarily, ''for convenience.'' Since the institution withdrew from the Program before being terminated, some State agencies have been uncertain of their authority to ask FNS to place the institution on the disqualified list. This rule clarifies that when this situation occurs, State agencies must disqualify the institution for failing to correct the serious deficiency, after which FNS will place the institution on the National disqualified list. This will prevent an institution with serious deficiencies from using termination for convenience as a means to avoid being placed on the National disqualified list. In order to provide institutions notice of the consequence of a voluntary termination of an agreement, this rule requires State agencies to disclose this consequence in the notices of serious deficiency, suspension, proposed termination, and proposed disqualification.

3. Corrective Action Timeframes (§ 226.6(c)(4))

How Long Does an Institution Have To Correct a Serious Deficiency?

In general, this rule establishes a 90 day limit on the time a State agency may allot for corrective action. However, a State agency may allow no longer than 30 days if the serious deficiency is based on a finding that the institution engaged in unlawful practices, submitted a false or fraudulent claim or information to the State agency, or has been convicted of or concealed a criminal background. Nothing in this section is intended to permit an institution to submit an invalid claim for reimbursement during the period of corrective action, or for the State agency to pay such a claim.

May a State Agency Ever Provide an Institution With More Than 90 Days To Correct a Serious Deficiency?

Yes. For serious deficiencies requiring the long-term revision of management systems or processes, the State agency may permit the institution to have more than 90 days to complete the corrective action, as long as a corrective action plan is submitted to and approved by the State agency within 90 days (or such shorter deadline as the State agency may establish). The corrective action plan must include milestones and a definite completion date that the State agency will monitor. The finding of serious

deficiency will remain in effect until the State agency determines that the institution has corrected the serious deficiencies within the allotted time.

May a State Agency Provide an Institution With Less Than 30 or 90 Days To Correct a Serious Deficiency?

Yes. Thirty and 90 days are only the maximum amount of time a State agency may provide an institution to correct various types of serious deficiencies (except for serious deficiencies requiring the long-term revision of management systems or processes as discussed above). Depending on the nature or severity of the problem, State agencies may establish shorter periods for corrective action. For example, a sponsoring organization that fails to pay its providers in accordance with the regulations at § 226.16(g) should be given only the time until it receives and disburses the next month's provider payments to rectify the situation, not 90 days. Even when the maximum corrective action periods are used, a State agency may also establish interim deadlines (e.g., 30- and 60-day reports) for the institution to document its progress toward correcting deficiencies.

How Can the State Agency Tell if an Institution's Corrective Action Will ''Fully and Permanently Correct'' the Serious Deficiency?

At a minimum, the State agency must review documentation submitted by the institution that demonstrates the serious deficiency has been corrected in such a manner that it is unlikely to recur. Often, the State agency will have to conduct an onsite review to determine whether the corrective action has been taken and whether it fully and permanently corrected the serious deficiency.

Some corrective actions ''look good on paper,'' but do not permanently resolve the longer-term problem which gave rise to the serious deficiency that was identified. If, for example, a sponsoring organization documented that it had assigned additional staff to monitoring to address an inability to perform the required number of facility reviews, but did so by transferring claims staff and compromising its ability to properly process claims, it would have addressed one deficiency by creating another. Therefore, we urge State agencies, whenever possible, to make onsite visits to verify and evaluate an institution's implementation of corrective action.

4. Suspension of an Institution's Participation (§ 226.6(c)(5))

May a State Agency Ever Terminate a Participating Institution's Agreement Before Completion of Its Administrative Review?

Section 243(c) of ARPA amended § 17(d)(5)(D)(i) of the NSLA to state that, ''An institution * * * shall be provided a fair hearing * * * prior to any determination to terminate participation by the institution * * *'' This means that if an institution requests an administrative review of a proposed termination, its Program agreement may not be terminated until the completion of the administrative review. This is more fully discussed in Part I(E) of the preamble below.

However, §§ 17(d)(5)(C)(ii) and 17(d)(5)(D)(ii)(I) of the NSLA (as amended by § 243(c) of ARPA and § 307(c) of the Grain Standards Act) provide for the ''suspension'' of an institution's participation prior to any administrative review of the proposed termination in two situations:

- If the State agency determines that there is imminent threat to the health or safety of a participant, or the entity engages in any activity that poses a threat to the public health or safety, the State agency must suspend the institution's participation, without the opportunity for corrective action; and
- If the State agency alleges that an institution has knowingly submitted false or fraudulent claims for reimbursement, the State agency may suspend the institution's participation after completion of an independent review, but prior to the conclusion of the administrative review of the proposed termination.

The NSLA recognizes that, in some instances, continued participation pending completion of the termination proceedings and any administrative review would be inappropriate due to the danger to participants, to the public, or to the Program's integrity. The suspension of day care homes is discussed in Part III.

What Is ''Suspension''?

This rule amends § 226.2 to define ''suspended'' as the status under which an institution or day care home is temporarily ineligible for Program participation (including Program payments). Although the Program agreement has not been formally terminated, the institution or day care home may not participate in the Program during the period of suspension.

How Long May a Suspension Last?

A suspension remains in effect until the serious deficiency is corrected (in the case of a suspension based on a false or fraudulent claim) or the completion of any administrative review of the proposed termination. However, this rule stipulates that in no case may a suspension last longer than 120 days. Although the 120-day limit in § 17 of the NSLA is linked to a suspension for false or fraudulent claims, we have adopted this limit as a reasonable period of suspension for health and safety reasons as well. After 120 days, we would expect the appeal process to be concluded and would further expect that, in the case of an imminent threat to health and safety, the appropriate licensing officials would have taken action to suspend or revoke an institution's license.

May the State Agency Later Reimburse the Institution for Meals Served and Administrative Costs Incurred if the Institution Prevails in Its Administrative Review?

Yes. The institution may continue to operate at its own risk during the period of suspension. If the suspended institution prevails in the administrative review, the State agency must pay any claims for reimbursement for eligible meals served and allowable administrative costs incurred during the suspension period.

If the Suspended Institution Is a Sponsoring Organization, Will Its Sponsored Facilities Lose Their Program Benefits During the Period of the Suspension?

No. Amended § 17(d)(5)(ii)(III)(ee) of the NSLA requires the State agency ''to ensure that payments continue to sponsored centers and family and group day care homes meeting program requirements'' during the period of their sponsor's suspension.

What Does ''Immediate Suspension'' Mean When ''Public Health or Safety'' Is Threatened?

Because an institution (except for a family day care home sponsoring organization, which does not actually provide care to children) may not participate in CACFP without a license or alternate approval, and because the law uses the phrase ''imminent threat'' to health or safety, we believe that Congress intended to provide State agencies with the authority to suspend participation prior to formal revocation of the institution's license or approval. Thus, if State health or licensing officials have cited an independent center for serious health or safety

violations, the State agency must immediately suspend the center's CACFP participation prior to any formal action to revoke the independent center's licensure or approval. However, if a State agency finds unhealthy or unsafe conditions that pose an imminent threat to health or safety when conducting a review, and the licensing agency cannot make an immediate onsite visit, there may be a delay before the State CACFP agency can act. In these cases, this rule requires the State agency to immediately notify the appropriate State or local licensing and health authorities and to take action that is consistent with the recommendations and requirements of those authorities.

In situations involving threats to public health or safety, there is no opportunity for the independent center to take corrective action, nor would there be a ''notice of intent to suspend payments'' (see the next question and answer below for applicability in suspensions for submission of false or fraudulent claims). This approach recognizes the seriousness of these situations. Instead, the State agency must simultaneously provide the independent center with a notice of serious deficiency; a notice of intent to terminate participation and disqualify the institution and any responsible principals or responsible individuals; and a notice that Program payments have been suspended pending the completion of the administrative review (if one is requested by the independent center).

How Does the Process for Suspensions Based on False or Fraudulent Claims Differ From Those Based on Imminent Threats to Health or Safety?

The law now mandates suspensions whenever a State agency determines that there is imminent threat to health or safety and specifies that there is no opportunity for corrective action in these cases. The law specifies a somewhat different approach for cases in which a State agency determines that an institution has knowingly submitted false or fraudulent claims for reimbursement. In these cases, State agencies are authorized, but not required, to suspend Program participation. In addition, suspensions based on allegations of false or fraudulent claims may be made only after a review by an ''independent and impartial official.'' The law defines an independent and impartial official as a person ''other than, and not accountable to, any person involved in the determination to suspend the institution.''

What Is the Purpose of This ''Independent Review'' (Referred to as a ''Suspension Review'' in This Rule)?

The purpose of the suspension review is to allow the State agency and the institution an opportunity to present written documentation relating to the allegation of a false or fraudulent claim prior to the suspension of Program payments. The law requires the suspension review official to ''determine, based on the review, whether the State agency has established, based on a preponderance of the evidence, that such institution has knowingly submitted a false or fraudulent claim for reimbursement.'' This rule calls such a review the ''suspension review'' to distinguish it from the administrative review that an institution may seek once a suspension for false or fraudulent claims has been imposed.

Does the Law Stipulate Procedures Pertaining to the Suspension Review?

Yes. The law requires that, in making his or her determination, the suspension review official consider written documentation submitted by the State agency and the institution. This rule requires State agencies to give institutions at least ten days to request an initial suspension review and to submit written documentation opposing the suspension.

What Happens if the Suspension Review Official Determines That the Proposed Suspension Is Not Appropriate?

No action is taken to suspend the institution's Program participation. However, the State agency's serious deficiency determination remains in effect and the institution must still take corrective action within the specified timeframe. If the State agency determines that the corrective action did not fully and permanently correct the serious deficiency, the State agency would proceed to send a notice of proposed termination and proposed disqualification. The institution would then have the opportunity to request an administrative review of the proposed actions. The suspension review is a limited review at a preliminary stage and only determines whether Program participation and Program payments continue. The suspension review does not resolve the question of whether the institution has been seriously deficient, whether the corrective action is adequate, or whether the proposed termination of the institution's agreement is justified.

What if the Suspension Review Official Upholds the State Agency, but the Administrative Review Official Later Upholds the Institution?

In that case, the institution may claim retroactive reimbursement for eligible meals served and any allowable expenses incurred during the suspension period.

5. FNS Determination of Serious Deficiency (§ 226.6(c)(6))

Under the current regulations at § 226.6(c), FNS may independently determine that an institution is seriously deficient. This rule retains this authority, but moves it to § 226.6(c)(6). This rule also revises the procedures for FNS determinations of serious deficiency to make them parallel to the revised procedures for State agencies' determinations of serious deficiency and adds procedures for FNS suspending an institution if there is an imminent threat to the health and safety of participants or the institution has submitted a false or fraudulent claim.

We do not envision the frequent use of this authority. Generally, State agencies will be in the best position to detect and take action with respect to seriously deficient institutions. Even when dealing with serious deficiencies detected during audits or investigations conducted by USDA's Office of Inspector General, it is the State agency, and not FNS, that will declare the institution seriously deficient, monitor corrective action, and take any additional actions that may be warranted. However, in dealing with multi-State or multi-regional institutions, FNS may be in the best position to coordinate actions in response to the serious deficiency. In addition, because we are now more likely to participate with State agencies in joint reviews of institutions, it is possible that we would declare a serious deficiency if the State agency was unwilling to do so.

6. National Disqualified List (§§ 226.2 and 226.6(c)(7))

The current regulations state that FNS will maintain a list of institutions whose participation has been terminated or whose application has been denied due to serious deficiencies. Section 243(c) of ARPA added a new § 17(d)(5)(E) to the NSLA, which expands the list's scope by requiring the Secretary to ''maintain a list of institutions, sponsored family or group day care homes, and individuals that have been terminated or otherwise disqualified from participation in the program,'' and make the list available to

State agencies for their use in reviewing applications to participate.

What Is the National Disqualified List?

As discussed in Part I(D)(2) of this preamble, this rule adopts ARPA's approach of distinguishing between seriously deficient institutions and disqualified institutions, individuals, and day care homes. In furtherance of this approach, this rule amends § 226.2 to define the list of institutions, responsible principals and responsible individuals, and day care homes disqualified from Program participation as the ''National disqualified list.''

How Does an Entity Get Put on the List?

An institution or day care home will be placed on the list only after having been declared seriously deficient, having an opportunity for corrective action, failing to take corrective action, and losing an administrative review (or failing to request an administrative review in a timely manner). Similarly, responsible principals and responsible individuals must first be named as responsible for an institution's serious deficiency(ies), receive an opportunity for corrective action, fail to take corrective action, and lose an administrative review (or fail to request an administrative review in a timely manner). At this point, the institution, day care home, or responsible principal or responsible individual is disqualified from Program participation and placed on the National disqualified list, and is prohibited from participating in the Program as an institution, sponsored center, day care home, or principal until removed from the list.

What if an Institution Participating in Several States Is Disqualified by FNS or a State Agency in Another State?

If an institution that participates in the Program in more than one State is disqualified from the Program by FNS or another State agency, any State agency holding an agreement with the institution must also terminate the institution's agreement. This action must be taken within 45 days of the date of the disqualification by FNS or the other State agency. Because the institution will have already had the opportunity for an administrative review covering the failure to correct the serious deficiencies that led to the initial disqualification, other State agencies are prohibited from offering the institution an administrative review of the termination action to be taken by the other State agencies. These requirements are in § 226.6(c)(6)(ii)(G) (disqualifications by FNS) and § 226.6(c)(3)(i) (disqualifications by another State agency).

How Long Will an Entity Remain on the List?

Institutions and responsible principals and responsible individuals will remain on the list until FNS, in consultation with the appropriate State agency, determines that the serious deficiency(ies) that led to their placement on the list has(ve) been corrected, or until seven years have elapsed since they were disqualified from participation. Day care homes will remain on the list until the State agency determines that the serious deficiency(ies) that led to their placement on the list has(ve) been corrected, or until seven years after they were disqualified from participation.

Similar to the past performance and criminal background eligibility criteria discussed in Part I(A)(4) of the preamble, above, we established seven years as the maximum period of an institution's or individual's disqualification. As noted previously in this preamble, the seven-year period underscores the importance of ensuring Program integrity, while recognizing the need to provide these individuals and institutions with a ''second chance'' at potential Program participation following a predictable period of time. However, if the institution, responsible principal or responsible individual, or day care home has failed to repay debts owed under the Program, they will remain on the list until the debt has been repaid.

What Will Happen to the Institutions and Individuals on the Prior FNS List?

Institutions and individuals placed on the FNS list of ''seriously deficient'' institutions prior to publication of this rule will be transferred to the new National disqualified list and will remain on that list until FNS determines, with the concurrence of the appropriate State agency, that the serious deficiency(ies) that led to their placement on the list has(ve) been corrected, or until July 29, 2009 (i.e. seven years after the effective date of this rule). As noted previously in this preamble, establishing the seven year period for institutions and individuals already on the list brings the previous list into conformance with the requirements being promulgated in this rule, and provides these institutions and individuals with a bar on their Program participation for a predictable period of time, before automatic removal from the list. As with the institutions or individuals placed on the National disqualified list after publication of this rule, if the institution or individual on the existing list fails to repay debts owed under the Program, they will remain on the list until the debt has been repaid.

What Happens to Sponsored Facilities When Their Sponsoring Organization's Agreement Is Terminated?

After the State agency issues a notice of proposed termination to a sponsoring organization, it will work with other sponsoring organizations in the State to ensure that there is no disruption of Program benefits to sponsored facilities that will be affected when their sponsoring organization's agreement is terminated. As noted in Part III(C) of this preamble, below, ARPA's restriction on day care home transfers from one sponsoring organization to another specifically allows a State agency to waive the provision for a day care home when its sponsoring organization's Program agreement has been terminated.

What About Sponsored Centers?

ARPA did not require us to establish a procedure for terminating the agreements of centers that participate under a sponsoring organization. However, in some instances the person responsible for a sponsoring organization's serious deficiency(ies) might be a person employed by or otherwise associated with a sponsored center, rather than with the sponsoring organization itself. Similarly, an institution that is on the National disqualified list as an independent center should not be able to avoid the effect of that disqualification by re-entering the Program as a sponsored center. Finally, an individual who is on the National disqualified list should not be permitted to participate in the Program as a family day care home provider or as a principal in a sponsored center or an independent center.

Therefore, this rule makes two changes designed to prevent such situations, any of which pose a threat to the Program's integrity. First, this rule amends § 226.2 to further define ''responsible principal or responsible individual'' to include a principal or individual associated with a sponsored center who is responsible for the center sponsor's serious deficiency(ies). This means that anyone responsible for the center sponsor's serious deficiency(ies) is subject to a proposed disqualification, regardless of whether he or she is associated with the sponsoring organization of centers, or with a sponsored center. Second, this rule amends §§ 226.16(b) and 226.6(b)(12) to prohibit a sponsoring organization from

submitting an application on behalf of a sponsored facility (or a State agency from approving such an application) if the facility itself or one of its principals is on the National disqualified list. This will prevent family day care homes or sponsored centers on the National disqualified list from re-entering the Program. It will also prevent an individual on the list for actions committed while associated with a sponsor of centers from re-entering the Program as a sponsored center, or an individual on the list for actions committed while a principal in a sponsored center from re-entering the Program as a principal in another institution (an independent center or a sponsoring organization of homes and/or centers).

Why Not Just Include Day Care Homes and Sponsored Centers on Separate State-Level Lists?

In most cases, a State-level list would be sufficient to ensure that disqualified institutions, sponsored centers, day care homes, and responsible principals and responsible individuals do not participate in the Program, either directly or as a principal. In some cases, though, these entities may attempt to evade their disqualification by seeking to participate in the Program in a different State. In order to address this situation, and for consistency and simplicity, all disqualified entities will be included on a single National-level list. For the same reason, this rule requires State agencies and sponsoring organizations to check the National disqualified list (rather than a State-level list) before approving an application from an institution, sponsored center, or day care home.

As noted in § 226.6(c)(7), we will make the National disqualified list available to all State agencies and all sponsoring organizations. This will permit State agencies and sponsoring organizations to consult a single list when determining whether an institution, sponsored center, or day care home is eligible for Program participation. To facilitate use of the National disqualified list, we are currently pursuing plans to make the list available in a password-protected electronic format.

7. State Agency List (§§ 226.2 and 226.6(c)(8))

What Is the State Agency List?

The State agency list will include those day care homes terminated for cause (see discussion of serious deficiency and termination procedures for day care homes in Part III(F) of the preamble, below) and those institutions and responsible principals and responsible individuals in the State that have been declared seriously deficient. In the interest of preserving flexibility for State agencies, the list may be kept in paper form, electronic form, or in retrievable, individual case files within the State agency. In the case of institutions and responsible principals and responsible individuals, the list will include information about all of the possible results after the State agency's transmission of a notice of serious deficiency (along with an identification of the principals and/or individuals responsible for the serious deficiency): successful corrective action; unsuccessful corrective action followed by notification of proposed termination and/or disqualification; suspension; administrative review; and agreement termination. This rule amends § 226.2 to add a definition of ''State agency list'' (either as actual lists or retrievable records) and adds § 226.6(c)(8), which requires each State agency to maintain a State agency list.

Why Bother With a Separate State-Level List?

A State-based list will be useful for analytic purposes. Although the National disqualified list will provide a complete picture of all institutions, individuals, and day care homes that have been *disqualified* and are ineligible for Program participation, the National list will not capture a great deal of additional information that is necessary for State agencies and FNS to assess the full impact of the ARPA provisions. For example, many institutions will be declared seriously deficient but will never appear on the National list, either because they successfully completed corrective action or because an administrative review official overturned the State agency's proposed termination of the institution's agreement. In order to properly assess ARPA's impact on Program management and integrity, it is critical for State agencies and FNS to have information about the number of institutions declared seriously deficient that were never placed on the National disqualified list, as well as the ways in which serious deficiencies were ultimately resolved short of termination. The State agency list established in this rule will capture information about the ultimate disposition of each case in which an institution was declared seriously deficient. The State agency list will be made available to FNS by the State agency upon request, so that it is possible to analyze National trends regarding the implementation of the ARPA provisions.

Why Is It Necessary for State Agencies and FNS To Have This Information?

The changes to serious deficiency, corrective action, administrative review and termination procedures mandated by ARPA were extensive, and had the potential to profoundly impact the Program. FNS must be able to quantify the impact of these changes, in order to assess the frequency with which certain actions are being taken, as well as the effectiveness of the changes. State agencies must also be able to have data that will allow them to assess their own implementation of these changes, identify any additional changes needed, and identify trends and training needs for State agency or institution staff.

What Must Be Done When the Rule Requires the State Agency To ''Update'' the State Agency List?

For each institution declared seriously deficient, and for each institution filing a request for an administrative review, the State agency will ''update'' the list whenever the next stage of action occurs. For example, when an institution is declared seriously deficient, the State agency is required to add the institution to the State agency list, as well as the basis for the determination of serious deficiency. Then, if the institution fully and permanently corrects the serious deficiency within the allotted time, the State agency records on the list that the corrective action is complete. Similarly, an institution requesting an administrative review of an overclaim would be placed on the list, as well as the result of the administrative review.

What About State Agencies That Already Have Lists of Disqualified Day Care Homes?

Any State agency that has a list of disqualified day care homes on July 29, 2002 may continue to prohibit participation by those day care homes. However, as with those institutions and individuals on the prior FNS list of ''seriously deficient'' institutions, the State agency must remove a day care home from its prior list no later than the time at which the State agency determines that the serious deficiency(ies) that led to their placement on the list has(ve) been corrected, or July 29, 2009 (i.e. seven years after the effective date of this rule). However, if the day care home has failed to repay debts owed under the Program, it must remain on the list until the debt has been repaid.

E. Administrative Reviews for Institutions and Responsible Principals and Responsible Individuals (§§ 226.2 and 226.6(k))

What Changes to the Administrative Review Procedures for Institutions Were Mandated by ARPA?

Before ARPA, § 17(e) of the NSLA required State agencies administering CACFP to ''provide, in accordance with regulations issued by the Secretary, a fair hearing and a prompt determination to any institution aggrieved by the action of the State as it affects the participation of such institution * * * or its claim for reimbursement under this section.'' Current CACFP regulations at § 226.6(k) establish the minimum requirements for such administrative reviews. However, § 243(c) of ARPA added § 17(d)(5)(D)(i) to the NSLA to require that, ''An institution or family or group day care home shall be provided a fair hearing in accordance with subsection (e)(1) [§ 17(e)(1) of the NSLA] *prior* to any determination to terminate participation by the institution or family or group day care home under the program'' (emphasis added). This provision substantially changes the sequence of events leading up to an institution or day care home's termination from the Program and for the first time establishes a requirement to offer administrative reviews to day care homes. The effect of this change on day care homes is discussed in Part III(F) of this preamble, while the effect on the termination of institutions' agreements is discussed here.

Under regulations in effect until October 18, 2000 (the required implementation date for ARPA's CACFP amendments on termination and administrative reviews), if an institution was determined seriously deficient and failed to complete the required corrective actions within the allotted time, the State agency notified the institution that its Program agreement was terminated and that the institution could seek an administrative review of this action. All Program payments to the institution ceased on the effective date of the termination notice. If the institution sought an administrative review of the termination, and its participation was restored as a result of the administrative review, it could seek reimbursement for eligible meals served and allowable administrative costs incurred during the period between the effective date of the termination and the decision on the administrative review.

Under the new procedures mandated by ARPA, a different sequence of events takes place. If a State agency determines that a seriously deficient institution failed to take the required corrective action within the allotted time, it notifies the institution that the State agency is proposing to terminate the institution's agreement and proposing to disqualify the institution and the responsible principals and responsible individuals. The State agency must also notify the institution and the responsible principals and responsible individuals that they may seek an administrative review of the proposed actions. However, if an administrative review is requested, the State agency must continue to pay any valid unpaid claims for reimbursement for eligible meals served and allowable administrative expenses incurred, unless the institution has been suspended from participation based on health or safety violations or false or fraudulent claims (as discussed in Part I(D)(4) of this preamble). Even if Program payments are suspended, the actual termination of the institution's agreement does not occur until after the administrative review official's decision is rendered.

Did ARPA Change the Actions That Are Subject to Administrative Review?

Yes. As noted above, the new procedures mandated by ARPA require State agencies to offer an administrative review to an institution prior to the termination of its agreement. This change requires several revisions to § 226.6(k) dealing with the actions that are subject to administrative review. These mandated changes also provide an opportunity to reorganize § 226.6(k) and to make other necessary changes to § 226.6(k) governing administrative reviews.

First, this rule groups all actions that are subject to administrative review in § 226.6(k)(2). Second, this rule clarifies that it is the notice of proposed termination of an institution's agreement that is subject to administrative review. The termination of the agreement does not occur until after the administrative review, and then only if the institution did not prevail. As a result of ARPA, the actual termination of the institution's agreement is no longer subject to administrative review because the administrative review has already occurred.

Third, this rule clarifies in § 226.6(k)(2)(iv) that State agencies must provide responsible principals and responsible individuals an administrative review of any proposed disqualification (see below for a further discussion of this issue). Finally, this rule makes clear in § 226.6(k)(2)(viii) that the recovery of an advance is subject to administrative review (see the additional discussion of the recovery of advances under ''What is the effect of the State agency action while the administrative review is pending?'')

Are There Any Actions That Are Not Subject to Administrative Review?

Yes. Even under the current regulations State agencies are not required to provide an administrative review of all actions. However, State agencies have informed us that, absent a clear delineation in the regulations of what is and is not appealable, they sometimes find themselves defending actions that were not intended to be appealable. This rule clarifies which actions are not subject to administrative review and groups them together in § 226.6(k)(3).

Are Serious Deficiency Determinations Subject to Administrative Review?

No. Currently, seriously deficient determinations are not subject to administrative review. This does not change as a result of ARPA, which anticipates an administrative review only after an institution is notified that its corrective actions to resolve a serious deficiency were incomplete or inadequate. A serious deficiency finding only serves to inform an institution that it is out of compliance with Program requirements and that certain other actions will occur if the institution fails to take corrective action within the allotted time. There is no effect on the institution's valid claim for reimbursement or participation unless it fails to take corrective action to correct the serious deficiency within the allotted time.

Do State Agencies Have To Provide Administrative Reviews to Responsible Principals and Responsible Individuals?

Yes. As noted above, this rule clarifies in § 226.6(k)(2)(iv) that State agencies must provide responsible principals and responsible individuals an administrative review of any notice of proposed disqualification. However, in most instances the institution's underlying serious deficiencies will be inextricably connected with the proposed disqualification of the responsible principal or responsible individual. As a result, this rule specifies in § 226.6(k)(8) that the State agency must in most instances combine the administrative review for the responsible principal or responsible individual with the administrative review for the institution.

There may be rare instances in which the interests of the institution and the

responsible principal or responsible individual conflict. This might occur when the person responsible for the institution's serious deficiency acted wholly without the knowledge of any of the institution's principals and without benefit to the institution. In such cases, and at the administrative review official's discretion, separate administrative reviews may be held if the institution does not request an administrative review or if either the institution or the responsible principal or responsible individual demonstrates that their interests conflict.

When Handling an Administrative Review, Are There Standard Procedures That All State Agencies Must Follow?

Yes. The current CACFP regulations permit State agencies either to establish their own administrative review procedures (subject to several basic requirements) or to follow the more detailed administrative review procedures set out in § 226.6(k)(1)–(12). This has caused some confusion over the years. This rule requires State agencies to develop their own administrative review procedures consistent with certain requirements specified by this rule. The majority of those requirements are the same as are found in § 226.6(k)(1)–(12) of the current regulations. We hope that this approach will result in greater uniformity throughout the Nation, while still permitting State agencies some flexibility. This uniformity will help ensure consistent action in all cases involving violations of Program requirements, and should lessen the chances of having administrative review decisions overturned by the courts. Uniform practice will be especially useful to institutions operating in more than one State and is imperative at a time when we are working with State agencies to improve Program management. These uniform standards are set forth at newly-reorganized § 226.6(k)(5).

Are There Any Changes to the Current Administrative Review Procedures?

Yes. In addition to requiring all State agencies to comply with the procedures in §§ 226.6(k)(1)–(12) of the current regulations, this rule makes minor changes to the language set forth at current §§ 226.6(k)(6) and (7), as discussed below.

Section 226.6(k)(6) currently requires that State review officials be independent and impartial. Institutions have sometimes argued that the administrative review officials are not truly ''impartial'', either because they are in the same organization as the official issuing the termination decision, or because the institution can only contact the hearing official by first contacting the State agency. It has long been our position that the mere fact that an administrative review official is in the same organization as the official who issued the action under review does not, by itself, undermine the administrative review official's impartiality. This rule makes clear in § 226.6(k)(4)(vii) that ''independent and impartial'' means that a person is prohibited from serving as an administrative review officer in any case in which he or she was involved in the action that is the subject of the administrative review, or if he or she has a direct personal or financial interest in the outcome of the administrative review. This rule also requires State agencies to permit institutions and responsible principals and responsible individuals to contact the administrative review official directly if they so desire.

Section 226.6(k)(7) currently requires that State review officials base their determinations on materials provided by the appellant and the State agency and on Program regulations. Some administrative review officials have read this to mean that they did not need to follow requirements in the statute or in other Federal regulations or Federal or State interpretations of those requirements (such as policy memoranda or guidance). This provision was meant to make clear that administrative review officials are to base their decision solely on the application of Program requirements to the facts in the case, as reflected in the submissions by the institution and the State agency. It is not the administrative review official's role to determine the validity of existing Federal or State requirements. These are legal issues for the courts. We have clarified this point in this rule (§ 226.6(k)(4)(viii)).

What Is an ''Abbreviated'' Administrative Review?

ARPA does not specify the type of ''fair hearing'' that must be provided to institutions. We have determined that there are two types of actions for which requiring a ''full'' administrative review (with the right to a hearing, etc.) is not warranted. The first is the denial of a new or renewing institution's application because the institution or any of its principals are on the National disqualified list (§ 226.6(b)(12)), have been declared to be ineligible for another publicly funded program during the prior seven years (§§ 226.6(b)(13) and 226.15(b)(7)), or have been convicted of an activity in the past seven years that indicated a lack of business integrity (§§ 226.6(b)(14) and 226.15(b)(8)). In each of these cases, the institution or the principals will have already had an opportunity to refute the charge (i.e. the action that led to the placement on the National disqualified list, the ineligibility determination for the other public program, or the criminal conviction). To offer a ''full'' administrative review in this case would lead to a false expectation that the institution or responsible principal or responsible individual would get a second chance to prove that the underlying action did not occur. These issues will have been fully reviewed by the appropriate authority and we do not intend to permit a second administrative review. Nor do we see the benefit of requiring a ''full'' administrative review in cases in which the only issue will be whether or not the affected party is really the same party that appears on the National disqualified list, was declared ineligible for another publicly funded program, or was convicted.

The second type of action is the denial of a new or renewing institution's application or the termination of a participating institution's agreement based on the submission of false information on the institution's application, including the concealment of a criminal background (§§ 226.6(c)(1)(ii)(A), (c)(2)(ii)(A), (c)(3)(ii)(A)). Again, these cases present only a narrow factual issue of whether the information submitted is indeed false. This issue can be adequately addressed through written submissions.

For these reasons, this rule limits the administrative review of these areas to a review of written submissions concerning the accuracy of the State agency's determination that: (1) the institution, one of its sponsored facilities, or one of the principals of the institution or its facilities is on the National disqualified list, has been determined ineligible to participate in another publicly funded program, or has been convicted of an offense indicating a lack of business integrity; or (2) information submitted on the institution's application is, in fact, false. We call this an ''abbreviated'' administrative review.

Part II. State Agency and Institution Review and Oversight Requirements

ARPA mandated three changes to State agency and sponsoring organization monitoring requirements. These changes require that:

- Sponsoring organizations conduct at least one unscheduled (unannounced)

review of each facility they sponsor in a three-year period;

- Sponsoring organizations employ ''an appropriate number of monitoring personnel based on the number and characteristics'' of facilities they sponsor; and
- State agencies review each institution in their State no less frequently than once every three years.

These changes are discussed below.

A. Unannounced reviews

Was It the Intent of ARPA To Reduce Current Requirements for Sponsoring Organization Reviews of Their Facilities?

No. Section 243(b) of ARPA amended § 17(d)(2) of the NSLA to require us to establish a policy under which unannounced reviews are made to sponsored facilities at least once every three years, and at least one review is made to each facility each year. Currently, § 226.16(d) of the regulations requires sponsoring organizations to review each facility they sponsor at least three times each year, unless they obtain permission to perform an average of three reviews for all of their facilities. When considering the Conference Report on ARPA, Senator Lugar, then-Chairman of the Senate Agriculture Committee, emphasized that the Department should view the monitoring requirements in ARPA as minimums, and may strengthen the requirements as necessary (*Congressional Record,* May 25, 2000, S. 4439). This rule retains the current regulatory requirement of three reviews per facility per year.

What Is an Unannounced Review?

This rule adds a definition to § 226.2 stating that an ''unannounced review'' is a review for which no prior notice is given to the facility or institution. We also wish to stress that State agencies and sponsoring organizations should not routinely follow the same cycle in conducting unannounced reviews (e.g., always reviewing providers in a particular town or neighborhood during the last two weeks of a calendar quarter). Instead, the pattern of unannounced reviews should be unpredictable, to ensure that the review is genuinely unannounced.

1. Unannounced Reviews by Sponsoring Organizations (§§ 226.2 and 226.16(d)(4))

Must a Sponsoring Organization Make All of Its Facility Reviews Unannounced?

No. Although some State agencies require sponsoring organizations to make all facility reviews unannounced, many sponsors in other States use scheduled reviews as opportunities to provide Program training and nutrition education. Promulgating a Federal requirement to make all reviews unannounced would take away this flexibility for State agencies, a concern especially in day care homes where providers need advance notice in order to participate in training during a monitoring review. Therefore, this rule amends § 226.16(d)(4) to require that two of the three annually required reviews of sponsored facilities be unannounced. If the third review is scheduled, rather than unannounced, then the sponsor may use that visit to provide any needed training. If the sponsor chooses to make all three annual reviews unannounced, or the State agency requires that all reviews be unannounced, the training needs of the sponsored center or day care home may be met in another manner (e.g., by providing training at a convenient location outside of normal business hours, or by providing on-line training through the Internet), or by making an additional visit to the facility to provide training.

Will Unannounced Reviews Be Effective? What if the Provider Is Not Home When the Unannounced Review Is Made?

A day care home provider's unexplained absence could indicate a serious accountability problem that the sponsor needs to address. In order to minimize this possibility, this rule adds § 226.18(b)(14) to require that a provider notify their sponsoring organization in advance whenever the day care home provider is planning to be out of their home with the children during the meal service period. This will better enable sponsoring organizations to plan their unannounced reviews in the most cost-effective manner possible. If a provider fails to notify the sponsor and an unannounced review is made during a scheduled meal time, claims for meals that would have been served during the unannounced review must be disallowed.

Sponsoring organizations or State agencies may establish additional requirements regarding unannounced reviews. Sponsoring organizations facing high travel costs to review day care homes, and sponsoring organizations concerned about the potential for Program abuse by providers who routinely claim to provide meal service to children outside their homes, may choose to impose more stringent requirements than those promulgated in this rule.

The primary purpose of this provision is to spare sponsoring organizations unwarranted expense in conducting unannounced reviews and not finding the provider at home, especially when the sponsor monitor must travel long distances to conduct the review. In addition, the requirement to notify the sponsoring organization when a provider is planning to be out of her home during the meal service period is essential to Program integrity because it will allow the sponsor the option to review the off-site meal service if it so desires.

Does This Rule Impose Any Other Requirements Relating to Unannounced Reviews?

Yes. This rule amends § 226.16(d)(4)(iv) to address the situation in which a sponsoring organization detects one or more serious deficiency in a review of a facility. Serious deficiencies are those listed in § 226.16(l)(2), regardless of the type of facility. In such cases, this rule requires the next review of the facility to be unannounced.

What Procedures Must Be Followed When a Sponsoring Organization Makes an Unannounced Review?

In recognition of the unique nature of providing day care, especially in one's private residence, and in order to protect the privacy of Program operators and the children they serve, this rule establishes several procedural requirements for unannounced reviews. We also strongly recommend that State agencies consult their legal counsel to ensure that any State statutes or administrative rules are reflected in the State agency's procedures for conducting unannounced reviews in the CACFP. However, at a minimum, the requirements pertaining to unannounced reviews specified in this regulation must be met. Thus, this rule amends § 226.16(d)(4)(vi) to specify that unannounced reviews must be made only during the facility's normal hours of child or adult care operations, and monitors making such reviews must provide photo identification that demonstrates that they are employees of the sponsoring organization.

2. Unannounced Reviews by State Agencies (§ 226.6(m))

Will This Rule Require That State Agencies Make Unannounced Reviews to Facilities?

Yes. However, a State agency making unannounced facility reviews could experience greater difficulty than a sponsoring organization would in making the same review. These

difficulties largely stem from the fact that State agencies are generally located farther away from the facilities being reviewed than are sponsors, thus increasing the review's potential cost. Nevertheless, OIG's audit and investigative work strongly suggests the need for some level of unannounced facility reviews by State agencies as well, because those sponsors that pay inadequate attention to accountability issues are less likely to uncover serious Program irregularities at their sponsored facilities. Therefore, this rule requires State agencies to conduct some unannounced facility reviews as part of their larger review of a sponsoring organization.

What Percentage of Facility Reviews Conducted by a State Agency Must Be Unannounced?

In recognition of the potential difficulties State agencies may face in conducting unannounced reviews of sponsored facilities, this rule amends § 226.6(m) [previously § 226.6(l)] to require that a minimum of 15 percent of a State agency's required facility reviews be unannounced. Thus, in a State with 10,000 participating sponsored facilities, with a requirement to conduct at least 800 facility reviews in a year, this rule requires that a minimum of 120 of those reviews (15 percent of 800) be unannounced. The State agency could decide whether it would be better to conduct a proportionate share of these reviews as a part of each sponsor review, or whether facilities sponsored by organizations with problematic Program records might be more in need of unannounced reviews.

Does This Rule Require State Agencies To Conduct Unannounced Reviews of Institutions?

No. However, we encourage State agencies to conduct unannounced reviews of institutions when appropriate. The results of OIG's audits have persuaded us that unannounced reviews of institutions can be very effective at detecting serious management and accountability issues that might be difficult to detect if the review were announced. Therefore, this rule adds the requirement that State agencies modify their current agreements with institutions to notify institutions of the right of the State agency, the Department, and other State or Federal officials to make announced or unannounced reviews of their operations; that unannounced reviews will be held 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.

3. Notification Requirements (§§ 226.6(f)(1), 226.16(d)(4)(v), and 226.18(d)(1))

Are There Any Notification Requirements Related to Unannounced Visits?

Yes. This rule requires in §§ 226.6(f)(1), 226.16(d)(4)(v), and 226.18(d)(1) that State agencies and sponsoring organizations notify institutions and facilities that they are subject to unannounced visits by the sponsoring organization, the State agency, the Department, or other State or Federal officials. State agencies must include this notice in their agreements with institutions. For sponsors of day care homes, this rule amends § 226.18(b)(1) to require sponsoring organizations to include in their sponsor-day care home agreements a provision stating that they will be reviewed on an unannounced basis, that they will make unannounced reviews only during the facility's normal hours of child care operations, and that monitors conducting unannounced reviews will have photo identification which demonstrates that they are employees of the sponsoring organization. Sponsoring organizations must amend their agreements with day care homes that are participating in the Program on July 29, 2002 to include this notice of unannounced reviews no later than August 29, 2002.

Because sponsors of centers are not required to enter into agreements with their sponsored centers, this rule amends § 226.16(d)(4)(vii) to require such sponsors to provide their centers written notification of this information about unannounced visits. For sponsored centers participating on July 29, 2002, the notice must be sent 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.

B. Sponsor Monitoring Staff (§§ 226.6(f)(2), 226.16(b)(1), and 226.16(d)(4))

What Are ARPA's Requirements Regarding the Staffing of the Monitoring Function by Sponsoring Organizations?

Section, § 243(a)(8)(B) of ARPA amended § 17(a) of the law to require that, ''in the case of a sponsoring organization, the organization shall employ an appropriate number of monitoring personnel based on the number and characteristics of child care centers and family or group day care homes sponsored by the organization, as approved by the State (in accordance with regulations promulgated by the Secretary), to ensure effective oversight of the child care centers and family or group day care homes. * * *''

What Approaches Were Considered To Implement This Requirement?

In assessing alternative means of implementing this requirement, the Department considered four possible approaches:

- Requiring a specific number of facilities that each sponsor monitor would be responsible for reviewing (e.g., each monitor must review 50 facilities);
- Requiring a ceiling on the number of facilities each sponsor monitor would be responsible for reviewing (e.g., each monitor may review no more than 75 facilities per year);
- Setting no numeric requirements, but requiring each State agency to assess the adequacy of staff and resources devoted to the monitoring function when reviewing the sponsor's management plan; or
- Establishing a broad range of facilities per monitor, and requiring the State agency to determine where, within that range, each sponsor's ratio of monitors to facilities should fall.

Which of These Approaches Does This Rule Incorporate, and Why?

Although each of these alternatives has certain strengths, we chose the last alternative—setting a range of facilities per monitor and requiring the State agency to determine where, within that range, each sponsor's ratio of facilities should fall. This approach provides State agencies and sponsoring organizations with flexibility in meeting the requirement, while still setting some broad numerical parameters for sponsors and State agencies to work within. This rule establishes slightly different staffing requirements for sponsoring organizations of day care homes (50 to 150) and centers (25 to 150), as explained below.

Given the different administrative demands faced by sponsors in different areas, we do not believe that either of the first two alternatives—establishing a single number of homes per monitor, or setting a ''ceiling'' on the number of facilities to be monitored—could be productively applied to every sponsoring organization across the country. For example, due to travel time, sponsoring organizations that recruit in rural areas (as encouraged by § 17(f)(3) of the NSLA) could need more

monitors to properly monitor the same number of homes than a solely urban-based sponsoring organization would need to properly monitor the same number of providers. Similarly, sponsoring organizations with larger numbers of new and/or non-English speaking providers would likely incur higher per-home costs in monitoring than sponsors without such homes. Finally, although the third alternative provides maximum flexibility to State agencies, it does not represent a meaningful change from pre-ARPA requirements and lacks the specificity that some State agencies desire, and that we believe Congress intended, in passing this provision.

What Is the Specific Requirement for Sponsoring Organizations of Day Care Homes?

This rule amends § 226.16(b)(1) to require that every sponsoring organization devote the equivalent of one full-time staff person to monitoring for each 50–150 day care homes it administers.

How Did USDA Decide on 50–150 as the Appropriate Range for Sponsoring Organizations of Day Care Homes?

We started by estimating the amount of time that a day care home sponsoring organization would spend carrying out the Program's review requirements (an average of three reviews per home per year, two of which are unannounced). The Early Childhood and Child Care Study (1997) reported that, on average, day care home sponsoring organizations made five reviews or visits per home per year. If this is accurate, sponsoring organizations of day care homes may respond to the unannounced review requirement in this rule, and the other changes in the proposed rule published on September 12, 2000, by making fewer, but more extensive, reviews and devoting more time to the review and analysis of accountability-related documents such as daily meal counts, daily attendance logs, and enrollment forms. In addition, the conduct of unannounced reviews may add some time to the performance of a typical review, since some providers will not be home when reviews are conducted and others will not have required records in order prior to the review. In urban areas, a provider's unavailability is less likely to be a major problem, since other day care homes in the vicinity can be reviewed. However, in rural areas, where day care homes may be more widely dispersed, a provider's unexpected absence could add a significant amount of time to the conduct of the average review. Overall, we estimate that day care home sponsoring organizations will, on average, spend about 12–15 hours per home annually implementing the minimum monitoring requirements being promulgated in this rule: three reviews per year, two of which are unannounced, including pre-review scheduling and preparation, travel related to the review, conduct of the review, and post-review work.

Using a 2,080 hour work year (less time off for vacation, illness, and holidays), we estimate that the average full-time monitor would be able to perform a minimum of three thorough reviews per year, which include all the review elements being proposed in this rule, for between 120–160 day care homes. However, taking into account the possible variation in the *types* of day care homes being sponsored, this rule requires that each full-time monitor be responsible for reviewing between 50 and 150 day care homes per year, depending on the geographic dispersion, experience level, and overall composition of the sponsoring organization's providers.

What Is the Staffing Standard for Monitoring by Sponsoring Organizations of Centers?

Although the Early Childhood and Child Care Study states that center sponsors currently spend about 60 hours per year monitoring each sponsored child care center, this figure seems implausible compared to the estimates of time spent by sponsors in monitoring each day care home. Part of the difference is accounted for by factors extraneous to the CACFP. For example, Head Start centers participating in CACFP (which account for about a third of all CACFP centers) are visited an average of 26 times per year (or approximately once for every week and a half of operation, since many Head Start centers do not operate on a year-round basis). However, these reviews or visits focus on Head Start, rather than CACFP, requirements; the proportion of review time devoted to CACFP meal service and recordkeeping requirements is not known, but is likely to account for a fairly small fraction of the overall time spent on the review. Similarly, a significant minority of center sponsors reported reviewing or visiting their centers once or more per week, but this was due to the fact that the sponsor and center were co-located (i.e., housed at the same location).

We believe that, once Head Start and co-located centers are removed from the equation, the average center sponsor can complete the requirement for three reviews per year in about the same amount of time that home sponsors spend in monitoring their providers: roughly 12–15 hours per year, including review preparation and follow-up. Therefore, this rule amends the introductory text of § 226.16(d)(4), and §§ 226.16(d)(4)(v) and 226.6(f)(2), to require a sponsoring organization of centers to employ one full-time monitor for every 25–150 centers it sponsors. The provision of a lower end of this range recognizes that center sponsors administering the Program in larger centers necessarily spend more time per review due to their review of household free and reduced price applications on file. We especially invite comment on this requirement from center sponsors and State agencies, but ask that these comments provide us with a detailed account of the amount of review time typically devoted to CACFP and non-CACFP related topics at a sponsored center.

How Will State Agencies Implement This Requirement for a Specific Sponsoring Organization?

Our decision to specify a range of facilities that each monitor could review means there will be room for some variation in each State agency's application of this requirement. However, to ensure that there is at least broad uniformity among State agencies in implementing this provision, this rule further amends § 226.16(b)(1) to clarify that the monitoring standard is based on ''the equivalent of one full-time staff person'' (i.e. 2080 hours/year, less an average employee's time off for paid holidays and leave) and that the monitoring staff equivalent may include time spent on scheduling, travel, the review itself, follow-up and report-writing for one full-time staff year [2,080 hours]. We also wish to emphasize that this time may be split among more than one person, depending on each person's other duties and the amount of time spent on these duties, as documented in the sponsor's management plan.

In addition, this rule amends § 226.6(f)(2) to require each State agency to develop factors (e.g., rural vs. urban, geographic dispersion of facilities, literacy and language proficiency of providers) that the State agency will consider in determining whether a sponsoring organization has sufficient monitoring staff. State agencies must use these factors and the staffing ranges established by this rule when they review and approve sponsoring organizations' management plans and budgets.

In implementing this requirement, State agencies must carefully review the sponsoring organization's budget and

management plan to ensure that they are analyzing this ratio in terms of full-time monitoring staff equivalents. Because many sponsoring organizations hire geographically-dispersed, part-time monitors, State agencies will need to know the duties and responsibilities of each sponsoring organization employee involved in monitoring in order to ensure that they are truly evaluating the number of full-time staff years committed to the monitoring function.

How Much Time Will Sponsors Have To Implement This Provision?

Participating sponsors will have until July 29, 2003 to submit a new management plan or an amendment to their management plan that complies with the new monitor staffing requirements. However, all management plans submitted by new sponsoring organizations applying for participation after the effective date of this rule must demonstrate a level of staffing devoted to monitoring that falls within the home-to-monitor range specified in this rule at § 226.16(b)(1).

C. State Review Cycle (§ 226.6(m)(4))

What are the Current Regulatory Requirements for the Frequency of State Agency Review of Institutions?

Section 226.6(l) of the current regulations [redesignated § 226.6(m) in this rule] requires State agencies to monitor at least one-third of all institutions in their State each year, and to review each institution at least once every four years (except for sponsors of 200 or more day care homes, which must be reviewed every other year).

How did ARPA Change These Requirements?

ARPA specified that each institution be reviewed no less frequently than once every three years, instead of once every four years as required by the current regulations. This does not require a change to the requirement that the State agency review at least one-third of all institutions in each year, but requires us to revise the frequency of the reviews. Accordingly, this rule amends 226.6(m)(4)(i) of this rule to require State agencies to review each institution (other than certain sponsors) at least once every three years, rather than once every four years. This means that State agencies may not allow more than three fiscal years to elapse between institution reviews. Thus, an institution reviewed in October of 2000 (Fiscal Year 2001), would have to be reviewed again no later than the end of Fiscal Year 2004 (September of 2004). In order to implement this provision of ARPA, this rule also makes a conforming change to the cycle for verifying free and reduced price applications set forth in § 226.23(h).

Were Other Aspects of the Review Requirements Changed as Well?

Yes. Audit and review findings have underscored that, although sponsoring organizations of centers administer CACFP in fewer facilities than large sponsors of day care homes, they should still be reviewed more frequently than independent centers or smaller sponsors (i.e., sponsors of fewer than 100 facilities). In addition, some State agencies and sponsoring organizations have reported a tendency of some less-well-managed day care home sponsoring organizations to keep their total number of sponsored day care homes below 200 to avoid more frequent State agency oversight. In order to ensure adequate State agency oversight, this rule further amends § 226.6(m)(4) by lowering the threshold for biennial review for both types of sponsoring organization (home and center) from 200 to 100 facilities.

What Related Changes Are Made by This Rule, and Why?

In addition, this rule makes one other change designed to fully address the integrity provisions of ARPA and the types of problems documented in management evaluations and the OIG audits. This rule requires at § 226.6(m)(2) that State agencies target for more frequent review those institutions whose prior review included a finding of serious deficiency, as defined in § 226.6(c). This will ensure that State agencies continue to monitor institutions that have been seriously deficient and ensure that successful corrective action has been fully and permanently implemented.

Part III. Other Operational Provisions

A. Definition of Institution (§ 226.2)

How and Why Was the Definition of ''Institution'' Modified by ARPA?

Section 243(a)(1)-(7) of ARPA restructured § 17(a) of the NSLA, which defines an ''institution'' and sets forth the basic requirements for Program participation, such as licensing or approval. The primary purpose of this restructuring was to make these requirements for institution eligibility easier to understand. In addition, the definition of ''institution'' was revised to include sponsors of centers. Until enactment of ARPA, sponsors of child care centers had not been specifically mentioned in § 17(a) of the NSLA. However, center sponsors have long participated in CACFP and are specifically included in the regulatory definition of ''institution'' at § 226.2. Therefore, it is not necessary for us to amend this definition as a result of this change to the statute.

However, this rule does amend the definition of ''institution'' for another reason. Prior to enactment of the William F. Goodling Child Nutrition Reauthorization Act of 1998 (Pub. L. 105–336, October 31, 1998), emergency shelters received meal reimbursements under a separate ''Homeless Child Nutrition Program'' that was directly administered by USDA and was not a part of any specific child nutrition program. No reference to them was made in the regulatory definition of ''institution.'' Public Law 105–336 expanded participation in that program to children through the age of 12, made the program a part of the CACFP, and amended the definition of ''institution'' in § 17(a) of the NSLA to include emergency shelters. Accordingly, this rule adds a new definition of ''emergency shelter'' to § 226.2 and amends the definition of ''institution'' to include emergency shelters serving homeless children.

B. Ceiling on Administrative Reimbursements for Sponsors of Centers (§§ 226.6(f)(3), 226.7(g), 226.16(b)(1))

Why Does the Law Establish a Ceiling on Center Sponsors' Reimbursable Administrative Costs?

OIG audits and State and Federal reviews uncovered a number of situations in which sponsors of centers were using too high a percentage of the meal reimbursement to cover their administrative expenses. When this occurs, less of the meal reimbursement is received by the sponsored center, making it less likely that a high-quality, nutritious meal that meets the Program's meal pattern requirements is being served to participants.

In response to these findings, Congress capped the reimbursable administrative costs of center sponsors at 15 percent of the total meal reimbursements earned by their sponsored centers. Accordingly, this rule amends § 226.16(b)(1) to require that the administrative budget submitted by a sponsoring organization of centers, and the actual administrative costs of such a sponsoring organization, not exceed 15 percent of the meal reimbursements estimated to be earned by its sponsored centers during the budget year, unless the State agency grants a waiver. Thus, if the centers sponsored by a particular sponsoring organization earn $1 million per year in meal reimbursements, the sponsored

centers must receive at least $850,000 for their operating costs (i.e. the cost of their food service), and will receive more than $850,000 if the sponsoring organization's budget is approved for less than $150,000 in reasonable, necessary, and allowable administrative costs.

Does This Mean That a State Agency can Require a Center Sponsor To Retain less Than 15 Percent of its Centers' Reimbursements to Cover its Administrative Expenses?

Yes. The 15 percent figure is a ceiling, not a floor. In other words, a center sponsor may use up to 15 percent of the meal reimbursement for administrative costs only if its budget, as approved by the State agency, includes this amount of allowable, reasonable, and necessary administrative expenses.

Could a State Agency Choose to set a Statewide Limit of less Than 15 Percent for all Center Sponsors?

No. State agencies are not permitted to set Statewide ceilings below 15 percent for all sponsoring organizations of centers. Each sponsoring organization's budget must be evaluated individually to determine the appropriate level of administrative funding.

What Constitutes an ''Administrative Cost''?

Section 226.2 of the current regulations defines both ''administrative costs'' and ''operating costs.'' Administrative costs are those incurred by an institution related to planning, organizing, and managing a food service under the program. For sponsors of centers, the primary administrative costs would be claim preparation, free and reduced price eligibility determinations, and monitoring and training of the sponsored facilities. Operating costs are those expenses incurred by an institution in serving meals to participants. In the case of sponsors of centers, this funding would ''pass through'' to their sponsored centers to cover the cost of food service.

Does the 15 Percent cap Apply To Administrative Costs Incurred By Sponsored Centers?

Yes. The 15 percent cap applies to all administrative costs, whether incurred by the sponsoring organization or the sponsored centers. It is our expectation that, if a center chooses to be sponsored in CACFP, it makes that choice due to an unwillingness or inability to perform the administrative tasks required under Program regulations (claims preparation, free and reduced price eligibility determinations, recordkeeping). Therefore, there should be few, if any, administrative expenses incurred by the sponsored center, and they should not detract from the 85 percent of meal reimbursement reserved for the food service under the 15 percent ceiling. If any of the primary administrative functions were being performed by the sponsored center, it would remove the need for the sponsor and would provide the sponsoring organization of centers with a means of evading the cap by shifting administrative costs to their sponsored centers.

Couldn't the 15 Percent Limit Be Evaded if a Sponsored Center Became an Independent Center, but Then Contracted With its Former Sponsoring Organization To Perform Administrative Services, and Paid the Former Sponsor More Than 15 Percent of the Meal Reimbursement To Perform These Administrative Duties?

No. Although contracting out is generally permissible, the current regulations at § 226.15(c) prohibit institutions from contracting out for management of the Program. If the former sponsor were hired to perform all of its previous duties related to application processing, claims submission, and recordkeeping, the now-independent center would be in violation of this regulatory prohibition.

Could a State Agency Approve a Center Sponsor's Budget for Administrative Expenses in Excess of 15 Percent?

Yes. The law permits a State agency to waive the 15 percent ceiling if the center sponsor ''provides justification to the State that the organization requires funds in excess of 15 percent . . . to pay the administrative expenses of the organization.''

What Types of Circumstances Would Justify a Waiver?

ARPA permits a State agency to waive the 15 percent ceiling in recognition of the higher costs faced by certain center sponsors. For example, if a sponsor runs the Program in 50 centers scattered across ten rural counties spanning several hundred miles, its travel costs for monitoring would necessarily be much higher than those incurred by a sponsor administering the Program in 50 centers located in a single urban area. Similarly, a sponsor with non-English-speaking staff at sponsored centers might face higher administrative costs resulting from language barriers and the cost of translations.

Finally, consider the case of two sponsors, each of which administers the Program in 50 centers with an average daily attendance of 2,000 for 22 serving days of lunch and breakfast. If 80 percent of the children in Sponsor A's centers were eligible for paid meals and 20 percent were eligible for free meals, Sponsor A's total meal reimbursement for the month would be $42,944 (based on rates in effect as of May, 2002). In contrast, if 80 percent of the children in Sponsor B's centers were eligible for free meals and 20 percent were eligible for paid meals, Sponsor B's total meal reimbursement for the month would be $117,656. Because the free meal reimbursement is so much higher than the paid reimbursement, the total meal reimbursement on which the maximum allowable administrative costs are calculated is far smaller for Sponsor A than Sponsor B. Therefore, Sponsor A would probably be justified in retaining a higher percentage of its sponsored centers meal reimbursements than would Sponsor B. The law provides State agencies with the ability to take these types of factors into account when considering a center sponsor's request for a waiver of the 15 percent ceiling. State agencies are also encouraged to contact their FNSROs when analyzing requests for such waivers.

How will FNS Determine Whether State Agencies are Properly Using Their Waiver Authority?

We will include in management evaluations a review of the State agency's center sponsor administrative budget review and approval process. In addition, this rule amends § 226.6(f)(3) to require State agencies to submit copies of center sponsor waiver approvals and denials to their FNSRO.

Are the Rules Different if the Sponsored Centers are ''Affiliated'' With Their Sponsoring Organization (i.e., Centers That are Owned by, or are Part of the Same Legal Entity as, the Sponsor)?

No. Congress makes no distinction among types of center sponsors. This means that a sponsoring organization of affiliated centers must ensure that at least 85 percent of the meal reimbursement is devoted to operating costs.

Won't a Sponsor Selling Meals to its Centers—Whether Affiliated or Unaffiliated—Retain Over 15 Percent of the Total Reimbursement?

Most likely, yes, because it will retain up to 15 percent of the meal reimbursement for its administrative costs, and will retain additional funds to cover the cost of preparing and delivering meals to its sponsored centers. However, this still fulfills the

law's intent that no more than 15 percent of the total reimbursement be used to pay administrative costs.

Would the Rules be Different for Proprietary Center Sponsors Because of Their Profit-Making Nature?

No. The law still requires that at least 85 percent of the reimbursement be used for operating costs (i.e. the cost of the meal service). In addition, all institutions must maintain a nonprofit food service.

What if, Despite Having an Approved Budget for less Than 15 Percent of Total Reimbursements, a Sponsor of Centers Expends More Than 15 Percent of Total Reimbursements for Administrative Costs During the Course of a Year?

The law limits the actual reimbursable administrative expenses of a sponsoring organization of centers to a maximum of 15 percent of the meal reimbursement. Thus, sponsoring organizations of centers and their State agencies must monitor the 15 percent limit throughout the year to ensure that unexpected variations in participation do not result in administrative expenditures over the 15 percent threshold. If, when a State agency reviews a sponsoring organization's end-of year expenditures, it discovers that the 15 percent ceiling has been exceeded, the State agency must take appropriate fiscal action.

C. State Agency Limits on Transfers by Day Care Homes (§§ 226.6(p) and 226.18(b)(13))

ARPA also addressed the issue of State agency-level controls on participation by day care homes. Section 243(f) of ARPA amended § 17(f)(3)(ii)(D) of the NSLA to require State agencies to limit day care home transfers from one sponsoring organization to another to no more than one time per year, except under extenuating circumstances such as the termination or withdrawal from the Program of a day care home's sponsoring organization. This rule amends redesignated § 226.6(p) (formerly § 226.6(o)) to require the State agency to establish a transfer policy consistent with the ARPA provision. In addition, this rule further amends redesignated § 226.6(p) and adds a new 226.18(b)(13) to require the sponsoring organization-day care home agreement to specify the State agency's transfer policy.

D. Notice to Parents or Guardians of Enrolled Participants (§ 226.16(b)(5))

What Information Does ARPA Require That Parents or Guardians of Participants Enrolled in CACFP Receive?

Section 243(b)(4) of the ARPA further amended § 17(d) of the NSLA by adding a new § 17(d)(3) to require that a sponsored center, a day care home, or the home or center's sponsoring organization provide basic Program information to parents or guardians of enrolled participants. For children and adults participating in CACFP at the time of ARPA's enactment (June 20, 2000), this information was to be provided within 90 days of enactment. For participants enrolled after enactment, the law requires that the information be provided to parents or guardians at the time of enrollment.

This rule amends §§ 226.16(b)(5), 226.17(d), and 226.18(b)(16) to require that any sponsor, either itself or through its sponsored facilities, must ensure that the required information is distributed to the parents or guardians of enrolled participants in accordance with the law. (For the sake of consistency and simplicity, we made clear that this requirement applies to all Program participants, not just to participating children.)

How can the Sponsor or Facility Obtain This Information Quickly in Order To Meet This Requirement?

We have developed and distributed to State agencies a brochure that provides basic information about the CACFP and its benefits. The names and telephone numbers of the sponsor and the State agency must be added to the brochure to meet the requirements of the law. We have also developed and distributed a one-page flyer that includes this basic Program information, and that will be less costly to reproduce than the brochure. Because the flyer was distributed electronically, it can easily be amended to include the name and telephone number of the appropriate State agency and the sponsor.

Some Urban Sponsors Deal With Providers and Households Speaking a Large Number of Languages. How can These Sponsors Meet the law's Requirement To Provide the Information in a Language Easily Understandable to the Household?

We have made the informational brochure available in English and Spanish and the flyer available in English, Spanish, and 18 other languages. We urge State agencies and sponsors to work together to obtain translations into any other language which is commonly spoken in the households of enrolled children.

E. Procedures for Recovery of Funds Disbursed to Institutions (§ 226.14(a))

Section 243(d) of ARPA amended § 17(f)(1) of the NSLA to establish certain requirements pertaining to the recovery of funds that have been disbursed to institutions. The law provided that such recovery ''shall not be paid from funds used to provide meals and supplements,'' may be repaid over a period of one or more years, and must include an opportunity for an administrative review for the institution prior to the recovery of funds.

Are Child Care Facilities Covered by This Provision?

No. The law refers only to disbursements to institutions by the State agency. Thus, if either a sponsor or a State agency uncovers invalid claims in its conduct of a facility review, or a sponsor makes such a discovery in editing the facility's claim, the facility's claim may be adjusted without offering an administrative review.

How do These Requirements Differ From Current Requirements in the CACFP Regulations?

The prohibition on repaying claims out of Program funds of any kind (meal or administrative funds) already exists, as does the institution's opportunity for an administrative review of any action that affects its reimbursement (§§ 226.14(a) and 226.6(k)). The provision pertaining to repayment schedules is new, although some State agencies already permit repayment schedules when collecting overclaims from institutions.

Are Repayment Schedules of at Least a Year Now Required?

No. The law says that recovered amounts ''may'' be paid to the State agency over a period of one or more years. It leaves to the State agency the discretion of whether and how to use a repayment schedule. It should also be noted that, although the law provides State agencies with this option, FNS may still insist on immediate repayment in full from a State agency, regardless of whether the State agency has chosen to provide an institution with a repayment schedule.

Does This Rule Include Other Requirements Pertaining to the Recovery of Disbursed Funds?

Yes. This rule makes clear our current position that State agencies must assess

interest during the period of repayment, including the period of administrative review, unless the administrative review officer overturns the State agency's action. In addition, State agencies must maintain lists of all funds recovery actions (excluding routine claim adjustments). In the interest of preserving flexibility for State agencies, the list may be kept in paper form, electronic form, or in retrievable, individual case files within the State agency.

Accordingly, this rule amends § 226.14(a) to specifically refer to the State agency's option to collect overpayments over a period of one or more years and to require State agencies to maintain lists or retrievable records of all funds recovery activities. This rule adds provisions in §§ 226.6(k)(10) and 226.14(a) to clarify our position on the collection of interest on overpayments.

F. Disqualification and Administrative Reviews for Day Care Homes (§§ 226.16(l) and 226.6(l))

As previously mentioned in Part I(D) of this preamble, § 243(c) of ARPA added a new § 17(d)(5) to the NSLA that requires us to establish procedures for the termination of participation of day care homes (in addition to institutions). These procedures must provide day care homes with an administrative review ''prior to any determination to terminate'' a day care home's participation. However, this requirement to offer an administrative review is limited to proposed termination actions. The requirement does not extend to any other action taken by a sponsor, including a sponsor's collection of overpayments from a day care home (see discussion in Part III(E) above). On April 12, 2001, we issued guidance on the effects of ARPA on the termination of the agreements of day care homes. This preamble contains a general discussion of the issues related to the termination of day care home agreements, but does not repeat the detailed discussions contained in that memorandum (which is available at www.fns.usda.gov/cnd).

Why Do the Parts of the Rule Relating to Actions To Terminate a Day Care Home's Agreement Use the Term Termination ''for Cause'?

Program regulations at § 226.18(b)(8) have long permitted sponsors and day care homes to terminate the sponsor-home agreement ''for convenience.'' Termination for convenience occurs when the sponsor or day care home terminates the agreement for considerations unrelated to either party's performance of Program responsibilities under the agreement. These are not the types of actions that ARPA intended to address.

ARPA's focus is on situations in which a sponsoring organization acts to terminate a day care home's agreement because the day care home has violated the agreement and therefore did not operate in accordance with Program requirements. If the sponsoring organization's proposed termination of a day care home's agreement is upheld in an administrative review, or if the day care home fails to request an administrative review, the day care home will be disqualified. This type of termination is commonly called termination ''for cause.'' In order to distinguish between these two types of action in the context of day care homes and their sponsors, this rule amends § 226.2 to add definitions of ''termination for convenience'' and ''termination for cause.''

What Process Must a Sponsor Use in Terminating a Day Care Home's Agreement for Cause?

This rule adds a new § 226.16(l), which requires a sponsoring organization to initiate action to terminate the agreement of a day care home for cause if the sponsoring organization determines the day care home has committed one or more serious deficiency. Section 226.16(l)(2) lists the serious deficiencies for day care homes and § 226.16(l)(3) sets out the requirements for the termination process. This process is quite similar, though not identical, to that used by State agencies in dealing with seriously deficient institutions, as revised by this rule (see Part I(D) of this preamble).

Do the Law's Provisions Regarding ''Suspension'' of Program Payments Based on Submission of False Claims Apply to Providers as Well as Institutions?

No. The law requires suspension of Program payments (without the opportunity for corrective action) if the provider has engaged in conduct that poses an imminent threat to children's health or safety or to public health or safety. There is no other provision authorized by law for suspension of provider payments. This rule addresses the suspension of provider funds due to health or safety violations in § 226.16(l)(4).

How Should the Law's Provisions Be Implemented With Regard to the ''Suspension'' of Program Payments to Providers Based on an Imminent Threat to Health or Safety?

Several aspects of the process for suspending providers who engage in conduct that poses an imminent threat to health or safety merit discussion.

First, § 17(d)(5)(C) states the Department may establish procedures requiring immediate suspension for institutions and day care homes ''without the opportunity for corrective action, if the State agency determines that there is an imminent threat to the health or safety of a participant at the entity or the entity engages in any activity that poses a threat to public health or safety.'' This language was repeated in implementation guidance we issued on July 20, 2000, and October 17, 2000. However, recognizing that the State agency would not have an agreement with a day care home, we clarified this statement in guidance issued on April 12, 2001, and in the language of this rule at § 226.16(l)(4). Sponsoring organizations, not State agencies, will bear the responsibility for making these decisions for the day care homes they sponsor.

Second, to parallel the provisions promulgated for the State agency's suspension of an institution based on an imminent threat to health or safety, this rule requires that, if State or local health or licensing officials have cited a day care home for serious health or safety violations, the sponsoring organization must immediately suspend the home's CACFP participation prior to any formal action to revoke the home's licensure or approval. However, if a sponsoring organization finds unhealthy or unsafe conditions that pose an imminent threat to health or safety when conducting a home review, and the licensing agency cannot make an immediate onsite visit, there may be a delay before the sponsor can act. In these cases, this rule requires the sponsoring organization to immediately notify the appropriate State or local licensing and health authorities and to take action that is consistent with the recommendations and requirements of those authorities.

Who Must Hold the Administrative Review?

This rule requires in § 226.6(l)(1) that State agencies ensure that day care homes are provided an opportunity for an administrative review of a proposed termination. State agencies may do this either by offering State-level administrative review or by requiring the sponsoring organization to offer an

administrative review. If a State agency elects to provide a State-level administrative review to one day care home, it must do so for all day care homes in the State.

What Options Does a Sponsoring Organization Have in Offering Administrative Reviews?

If a State agency chooses to require sponsoring organizations to provide the administrative reviews, it is the sponsoring organization's responsibility to ensure that the administrative review is provided in accordance with the requirements for day care home administrative reviews added by this rule in § 226.6(l). A sponsoring organization may do this by holding the administrative review itself, or by contracting with someone to provide the administrative review (such as a sponsor's association).

Are the Procedural Requirements the Same for an Administrative Review Conducted by a State Agency and One Conducted by a Sponsoring Organization?

Yes. The minimum procedural requirements for day care home administrative reviews are the same regardless of whether it is the State agency or the sponsor conducting the review. The procedures are a streamlined version of the procedures State agencies must follow for administrative reviews for institutions.

What Will Happen if a Sponsor Uses Termination for Convenience When They Should Use Termination for Cause?

Because the law clearly intends that poorly-performing and fraudulent providers be placed on a list which would disqualify them from Program participation, we believe it is necessary to underscore the importance of sponsoring organizations making meaningful distinctions between the bases for termination. To that end, this rule requires State agencies to include as part of their review of a sponsor's operation their proper implementation of this provision (see revised and redesignated § 226.6(m)(3)(iii)). The rule also requires State agencies to determine that a sponsoring organization is seriously deficient when it has terminated providers for convenience when a termination for cause was the appropriate course of action (see § 226.6(c)(3)(ii)(R), as added by this rule).

May Providers Still Terminate Their Agreements With a Sponsor ''for Convenience'?

Yes. Providers may still terminate their agreement with a sponsor ''for convenience.'' However, depending on the timing of this action and the nature of the State agency's implementation of ARPA's requirement for an annual transfer policy, the provider's termination for convenience could result in a lapse in their Program participation. Providers having questions on this subject should refer to the State agency for further guidance.

How Will State Agencies Be Able To Monitor Sponsors' Compliance With These New Termination and Appeal Procedures?

This rule establishes the minimum requirements for sponsoring organizations to use when determining a day care home seriously deficient, proposing to terminate a day care home's agreement for cause, and offering day care homes administrative reviews of such actions (§ 226.6(l)). This rule amends § 226.16(b)(6) to require sponsoring organizations to submit, as part of their Program applications, any supplemental procedures the sponsoring organization has established for taking these actions and for providing administrative reviews (if the sponsor has been charged with conducting the administrative reviews). In addition, this rule amends redesignated § 226.6(m)(3)(iii) to require State agency reviews of sponsoring organizations to evaluate implementation of procedures relating to serious deficiency, termination, and administrative review.

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 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 19,000 institutions (sponsoring organizations and independent child and adult care centers) in over 210,000 child and adult care facilities (child care centers, outside-school-hours care centers, adult day care centers, and family day care homes). The vast majority of institutions and facilities participating in CACFP are ''small entities''. However, the changes mandated by Public Laws 106–224 and 106–472 and 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 the agreements of day care homes. In short, there will be little or no impact on those entities administering the Program in accordance with the CACFP regulations, since the changes to the law were largely intended to improve compliance with existing regulations.

This rule will primarily affect the procedures used by State agencies in reviewing applications submitted by institutions that are participating or that wish to participate in the Child and Adult Care Food Program; in monitoring the performance of participating institutions; and in ensuring that appropriate and timely action is taken to correct serious deficiencies noted in an institution's operation of the Program. The rule will also impact sponsoring organizations, by requiring that they conduct unannounced reviews of their sponsored facilities, and some sponsoring organizations of centers, whose level of reimbursable Program administrative expenses will be capped at 15 percent of total meal reimbursements. Institutions, individuals, and day care home providers will be affected by the provision of an administrative review prior to their loss of Program benefits or the termination of their Program agreements. Those changes will not, in the aggregate, have a significant economic impact.

Regulatory Impact Analysis

This rule implements a number of changes to existing Program regulations. These changes are mandated by the NSLA, as amended by Public Laws 106–224 and 106–472, and are designed to improve management and financial integrity in the CACFP. These changes will affect all entities involved in CACFP, including USDA, State agencies, institutions, facilities, and participating children and their households. The entities 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 purposively selected CACFP institutions and facilities, and ''management

evaluations'' conducted by State agencies and FNS are not designed to capture representative information for the purpose of developing Nationally-valid estimates of fraud or mismanagement. While the OIG reports clearly illustrate that there are significant weaknesses in parts of the Program regulations, and that there have been significant weaknesses in oversight by some State agencies and institutions, neither the OIG reports nor any other data sources estimate the prevalence or magnitude of CACFP fraud and abuse.

This lack of information makes it difficult for USDA to estimate the amount of CACFP reimbursement lost due to fraud and abuse. For that reason, when the fiscal impact of these provisions was estimated by FNS, the Congressional Budget Office, and the Office of Management and Budget when Public Law 106–224 was enacted, only a few of the provisions were estimated to produce Program savings. Those estimates appear in the Regulatory Impact Analysis in Table ES–2, which is summarized below:

TABLE ES–2.—ESTIMATED SAVINGS OF RULE ($ IN MILLIONS)

Provision	2001	2002	2003	2004	2005	2001–2005	2006–2010	2001–2010
Tax-exempt, Prior ineligi-bility in other public programs, eliminate participation ''entitlement'' for instituitions	−3.2	−3.4	−3.7	−4.0	−4.2	−18.5	−25.8	−44.3
New sponsors must demonstrate need for services	−0.0	−0.5	−1.0	−1.4	−1.4	−4.3	−7.1	−11.4
15% cap on center sponsor administrative earnings	−13.8	−17.3	−21.6	−26.4	−31.9	−110.9	−279.1	−390.0
Limit facility transfers between sponsors	−0.0	−0.9	−1.0	−1.0	−1.1	−4.0	−6.5	−10.5

FNS had very little flexibility in implementing most of the provisions mandated by ARPA and the Grain Standards Act. As discussed throughout the preamble, above, and under ''Executive Order 13132'', below, where possible, we have made every attempt to ensure that the statutory provisions, as implemented in this interim rule, safeguard Program funds without unnecessarily limiting access to the Program by institutions, facilities, or children.

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 (7 CFR Part 3015, Subpart V, 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 section 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 seven years, our headquarters staff informally consulted with State administering agencies, Program sponsors, and CACFP advocates on ways to improve Program management and integrity in CACFP. Discussions with State agencies took place in the joint Management Improvement Task Force meetings held between 1995 and 2000; in three biennial National meetings of State and Federal CACFP administrators (1996 in Seattle, 1998 in New Orleans, and 2000 in Chicago); at the December 1999 meeting of 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 1996–2000; 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 required as a result of statutory changes enacted in Public Laws 106–224 and 106–472. Many of the individual provisions in these statutes were discussed in the meetings with State and local cooperators mentioned above, and the Department, State agencies, and local sponsoring organizations all provided input to the congressional authorizing committees that drafted these statutory changes. Although State agencies and local sponsoring organizations have some concerns about the implementation of the new termination and appeal procedures mandated by these laws, Congress attempted to balance the demonstrable need to improve Program compliance in CACFP with the protection of institutions and day care homes' ability to receive due process prior to having their Program participation terminated.

Extent to Which We Meet Those Concerns

FNS has considered the impact of these statutory changes on State and local administering agencies, and has followed congressional intent in attempting to balance Program integrity concerns with the need to maintain Program access for capable institutions and family day care homes. 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 law.

Public Law 104–4

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Pub. L. 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.

Public Participation

As noted in the **SUPPLEMENTARY INFORMATION** section of this preamble, we are publishing this interim rule without the prior notice or public comment generally required under section 553 of the Administrative Procedure Act (APA). Section 263(a) of ARPA specified that the Secretary must publish rules implementing ARPA's amendments to the CACFP provisions of the NSLA as soon as practicable, and without regard to the APA, Departmental policy regarding public participation, or the Paperwork Reduction Act. We are therefore required to publish a rule incorporating the ARPA changes without following the usual rulemaking procedures.

We are also publishing in this interim rule provisions implementing section 307 of the Grain Standards Act. Section 307 incorporated amendments to the hearing requirements established by section 243 of ARPA. It would be impractical to implement the provisions of ARPA without the inclusion of the modifications to the appeal process instituted in accordance with section 307 of the Grain Standards Act. For these reasons, we have determined in accordance with 5 U.S.C. 553(b)(3) that good cause exists for the promulgation of the provisions of this rule implementing section 307 of the Grain standards Act without prior notice and public comment. In order to improve administration of the rule, however, we are seeking public comment on all of its provisions and will make any appropriate changes based on the comments when the final rule is published.

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) 7 CFR §§ 226.6(k), 226.6(l), and 226.16(l) which establish administrative review procedures for institutions, individuals, and day care homes; and (2) 7 CFR Section 226.22 and 7 CFR 3015, which address administrative review procedures for disputes involving procurement by State agencies and institutions.

Paperwork Reduction Act

In accordance with § 3507(j) of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the information collection and recordkeeping requirements included in this interim rule have been submitted for emergency approval to the Office of Management and Budget (OMB). OMB has assigned control number 0584–0055 to the information collection and recordkeeping requirements. FNS intends to request continuation of that approval for three years and invites the general public and other public agencies to comment on the information collection impact of implementing this interim rule.

Written comments on the information collection requirements must be received on or before August 26, 2002 by the Office of Information and Regulatory Affairs, Office of Management and Budget (OMB), 3208 New Executive Office Building, Washington, DC 20503, Attention: Ms. Lauren Whittenberg, 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 required by 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 rule. This does not affect the 60-day deadline for the public to comment to the Department on the substance of the 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.

Type of request: Revision of existing collections.

Abstract: This rule revises: State agency criteria for approving and renewing institution applications and for terminating agreements with institutions; State- and institution-level monitoring requirements; State agency and sponsoring organization follow-up to ensure that appropriate and timely action is taken to correct serious deficiencies noted in an institution or day care home's operation of the Program; the level of reimbursable Program administrative expenses for sponsoring organizations of centers; and the administrative review procedures for institutions, individuals, and day care homes. The provisions of law that are implemented in this interim rule and are likely to have the greatest potential impact will require: State agencies to evaluate all Program applications in light of three ''performance standards'; time limits on the completion of corrective action by

institutions and day care homes that have been declared seriously deficient; payments to continue to seriously deficient institutions and homes until the conclusion of the appeal process, unless payments to the institution or home have been suspended for reasons related to health or safety concerns or the submission of a false or fraudulent claim; responsible principals and responsible individuals, as well as family day care homes whose agreements have been terminated for cause, to be placed on the National disqualified list; all State agencies to follow uniform procedures for administrative reviews (appeals); the establishment of an appeals process for family day care homes; sponsoring organizations annually to conduct a minimum of two unannounced visits to each of their sponsored facilities; State agencies to perform 15 percent of their required facility reviews unannounced; sponsoring organizations to meet minimum staffing requirements for performance of the monitoring function; and sponsors of centers to retain a maximum of 15 percent of Program funds for administrative expenses, unless a waiver is obtained from the State agency. These changes are primarily designed to improve Program operations and monitoring at the State and institution levels.

Estimated Total Annual Burden on Respondents:

Total Existing Burden Hours: 5,076,428.

Total Proposed Burden Hours: 5,093,852.

Total Difference: 17,424.

The changes in these information collection requirements will not be in effect until approved by OMB.

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 is revised to read as follows:

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

2. In § 226.2:

a. New definitions of *Administrative review, Administrative review official, Center, Days, Disqualified, Emergency shelter, Facility, Internal controls, National disqualified list, New institution, Notice, Principal, Renewing institution, Responsible principal or responsible individual, Seriously deficient, State agency list, Suspended, Suspension review, Suspension review official, Termination for cause, Termination for convenience, and Unannounced review* are added in alphabetical order; and

b. The definition of *Institution* is amended by adding the words '', emergency shelter'' after the words ''outside-school-hours care center''.

The additions read as follows:

§ 226.2 Definitions.

* * * * *

Administrative review means the fair hearing provided upon request to:

(a) An institution that has been given notice by the State agency of any action or proposed action that will affect their participation or reimbursement under the Program, in accordance with § 226.6(k);

(b) A principal or individual responsible for an institution's serious deficiency after the responsible principal or responsible individual has been given a notice of intent to disqualify them from the Program; and

(c) A day care home that has been given a notice of proposed termination for cause.

Administrative review official means the independent and impartial official who conducts the administrative review held in accordance with § 226.6(k).

* * * * *

Center means a child care center, an adult day care center, or an outside-school-hours care center.

* * * * *

Days means calendar days unless otherwise specified.

* * * * *

Disqualified means the status of an institution, a responsible principal or responsible individual, or a day care home that is ineligible for participation.

* * * * *

Emergency shelter means a public or private nonprofit organization whose primary purpose is to provide temporary shelter and food services to homeless families with children.

* * * * *

Facility means a sponsored center or a family day care home.

* * * * *

Internal controls means the policies, procedures, and organizational structure of an institution designed to reasonably assure that:

(a) The Program achieves its intended result;

(b) Program resources are used in a manner that protects against fraud, abuse, and mismanagement and in accordance with law, regulations, and guidance; and

(c) Timely and reliable Program information is obtained, maintained, reported, and used for decision-making.

* * * * *

National disqualified list means the list, maintained by the Department, of institutions, responsible principals and responsible individuals, and day care homes disqualified from participation in the Program.

New institution means an institution applying to participate in the Program for the first time, or an institution applying to participate in the Program after a lapse in participation.

* * * * *

Notice means a letter sent by certified mail, return receipt (or the equivalent private delivery service), by facsimile, or by email, that describes an action proposed or taken by a State agency or FNS with regard to an institution's Program reimbursement or participation. Notice also means a letter sent by certified mail, return receipt (or the equivalent private delivery service), by facsimile, or by email, that describes an action proposed or taken by a sponsoring organization with regard to a day care home's participation. The notice must specify the action being proposed or taken and the basis for the action, and is considered to be received by the institution or day care home when it is delivered, sent by facsimile, or sent by email. If the notice is undeliverable, it is considered to be received by the institution, responsible principal or responsible individual, or day care home five days after being sent to the addressee's last known mailing address, facsimile number, or email address.

* * * * *

Principal means any individual who holds a management position within, or is an officer of, an institution or a sponsored center, including all members of the institution's board of directors or the sponsored center's board of directors.

* * * * *

Renewing institution means an institution that is participating in the Program at the time it submits a renewal application.

Responsible principal or responsible individual means:

(a) A principal, whether compensated or uncompensated, who the State agency or FNS determines to be responsible for an institution's serious deficiency;

(b) Any other individual employed by, or under contract with, an institution or sponsored center, who the State agency or FNS determines to be responsible for an institution's serious deficiency; or

(c) An uncompensated individual who the State agency or FNS determines to be responsible for an institution's serious deficiency.

* * * * *

Seriously deficient means the status of an institution or a day care home that has been determined to be non-compliant in one or more aspects of its operation of the Program.

* * * * *

State agency list means an actual paper or electronic list, or the retrievable paper records, maintained by the State agency, that includes a synopsis of information concerning seriously deficient institutions and providers terminated for cause in that State. The list must be made available to FNS upon request, and must include the following information:

(a) Institutions determined to be seriously deficient by the State agency, including the names and mailing addresses of the institutions, the basis for each serious deficiency determination, and the status of the institutions as they move through the possible subsequent stages of corrective action, proposed termination, suspension, agreement termination, and/or disqualification, as applicable;

(b) Responsible principals and responsible individuals who have been disqualified from participation by the State agency, including their names, mailing addresses, and dates of birth; and

(c) Day care home providers whose agreements have been terminated for cause by a sponsoring organization in the State, including their names, mailing addresses, and dates of birth.

* * * * *

Suspended means the status of an institution or day care home that is temporarily ineligible for participation (including Program payments).

Suspension review means the review provided, upon the institution's request, to an institution that has been given a notice of intent to suspend participation (including Program payments), based on a determination that the institution has knowingly submitted a false or fraudulent claim.

Suspension review official means the independent and impartial official who conducts the suspension review.

Termination for cause means the termination of a day care home's Program agreement by the sponsoring organization due to the day care home's violation of the agreement.

Termination for convenience means termination of a day care home's Program agreement by either the sponsoring organization or the day care home, due to considerations unrelated to either party's performance of Program responsibilities under the agreement.

* * * * *

Unannounced review means an on-site review for which no prior notification is given to the facility or institution.

* * * * *

3. In § 226.6:

a. Paragraphs (b) and (c) are revised;

b. Paragraph (d)(3) is amended in the last sentence by removing the reference ''226.6(n)'' and adding in its place the reference ''226.6(o)';

c. Paragraph (f)(1) is amended by adding a new sentence at the end of the paragraph;

d. Paragraph (f)(2) is amended by removing the third sentence and adding in its place four new sentences;

e. Paragraph (f)(3) is amended by adding three new sentences at the end of the paragraph;

f. Paragraph (k) is revised;

g. Paragraphs (l)–(p) are redesignated as paragraphs (m)-(q) and a new paragraph (l) is added;

h. Newly redesignated paragraph (m) is revised;

i. Newly redesignated paragraph (p) is amended by adding two new sentences after the first sentence; and

j. Newly redesignated paragraph (q) is amended by removing the reference ''226.6(l)'' and adding in its place the reference ''226.6(m)''.

The additions and revisions specified above read as follows:

226.6 State agency administrative responsibilities.

* * * * *

(b) *Application Approval.* Each State agency must establish an application procedure to determine the eligibility under this part of applicant institutions, and facilities for which applications are submitted by sponsoring organizations. Any institution applying for participation in the Program must be notified of approval or disapproval by the State agency in writing within 30 days of filing a complete and correct application. If an institution submits an incomplete application, the State agency must notify the institution within 15 days of receipt of the application and must provide technical assistance, if necessary, to the institution for the purpose of completing its application. Any disapproved applicant must be notified of the procedures for seeking an administrative review (in accordance with paragraphs (k) or (l) of this section, as appropriate). The application procedures must include or conform to the following requirements:

(1) *Agreements.* The State agency, by written consent of the State agency and the institutions, must renew agreements with institutions not less frequently than annually. The State agency is prohibited from entering into an agreement that is effective during two fiscal years, but may nevertheless establish an ongoing renewal process for the purpose of reviewing and approving applications from participating institutions throughout the fiscal year;

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

(3) *Enrollment information.* Sponsoring organizations of day care homes must submit the current total number of children enrolled, with an assurance that day care home providers' own children enrolled in the Program are eligible for free or reduced price meals;

(4) *Nondiscrimination statement.* Institutions must issue a non-discrimination policy statement and media release;

(5) *Management plan.* Sponsoring organizations must submit a management plan;

(6) *Administrative budget.* Institutions must submit an administrative budget;

(7) *Licensing/approval.* Institutions must document that each facility for which application is made meets Program licensing/approval requirements;

(8) *Proprietary centers.* Institutions must document that each proprietary center for which application is made meets the definition of a proprietary title XIX center or a proprietary title XX center, as applicable and as set forth at § 226.2;

(9) *Commodites/Cash-in-lieu of commodities.* Institutions must state their preference to receive cash or cash-in-lieu of commodities;

(10) *Advance payments.* Institutions must state their preference to receive all, part, or none of the advance payment;

(11) *Unserved facilities or participants.*

(i) *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

(ii) *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.

(12) *National disqualified list.* A State agency is prohibited from approving an institution's application if the institution or any of its principals is on the National disqualified list, and is prohibited from approving an application submitted by a sponsoring organization on behalf of a facility if the facility or any of its principals is on the National disqualified list;

(13) *Other publicly funded programs.* (i) *General.* A State agency is prohibited from approving an institution's application if, during the past seven years, the institution or any of the institution's 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;

(ii) *Certification.* As part of an application, institutions must submit a certification regarding their past performance in other publicly funded programs. The certification shall include language stating that institutions and individuals providing false certifications will be placed on the National disqualified list and will be subject to any other applicable civil or criminal penalties. This certification will include:

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

(B) 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

(C) 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

(iii) *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;

(14) *Criminal convictions.*

(i) *General.* 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

(ii) *Certification.* As part of an application, institutions must submit a certification regarding any criminal convictions. The certification shall include language stating that institutions and individuals providing false certifications will be placed on the National disqualified list and will be subject to any other applicable civil or criminal penalties. This certification will state 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;

(15) *Truth of applications and 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;

(16) *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 shall be effective unless disapproved by the State agency;

(17) *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

(18) Each new or 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 new institution must demonstrate in its application that it is capable of operating in conformance with the following performance standards, and any renewing institution must demonstrate in its application that it currently operates in conformance with the following performance standards. The State agency must only approve the applications of those institutions that meet these performance standards, and must deny the applications of those institutions that do not meet the standards.

(i) *Performance Standard 1—Financial viability and financial management.* The new or 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 7 CFR Parts 3015 and 3016. To demonstrate financial viability, the new or renewing institution must document that it meets the following criteria:

(A) *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)(11) of this section. All sponsoring organizations must demonstrate that they will use appropriate practices for recruiting

facilities, consistent with paragraph (p) of this section and any State agency requirements;

(B) *Fiscal Resources and Financial History.* An 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

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

(ii) *Performance Standard 2—Administrative capability.* The new or 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 new or renewing institution must document that it meets the following criteria:

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

(B) If a sponsoring organization, documents in its management plan that it employs staff sufficient to meet the ratio of monitors to facilities set forth in § 226.16(b)(1), and the factors established by the State agency in accordance with § 226.6(f)(2); and

(C) 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

(iii) *Performance Standard 3—Program accountability.* The new or 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 new or renewing institution must document that it meets the following criteria:

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

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

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

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

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

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

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

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

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

(*1*) Provide adequate and regular training of sponsoring organization staff and sponsored facilities in accordance with §§ 226.15(e)(13) and 226.16(d);

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

(*3*) If applicable, accurately classify day care homes as tier I or tier II in accordance with § 226.15(f); and

(*4*) 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

(E) *Facility level operations.* All independent centers and sponsored facilities must follow practices which 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:

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

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

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

(*4*) Comply with civil rights requirements;

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

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

(c) *Denial of applications and termination of agreements.* (1) *Denial of a new institution's application.*

(i) *General.* If a new institution's application does not meet all of the requirements in paragraph (b) of this section and in §§ 226.15(b) and 226.16(b), the State agency must deny the application. If, in reviewing a new institution's application, the State agency determines that the institution has committed one or more serious deficiency listed in paragraph (c)(1)(ii) of this section, the State agency must initiate action to:

(A) Deny the new institution's application; and

(B) Disqualify the new institution and the responsible principals and responsible individuals (e.g., the person who signs the application).

(ii) *List of serious deficiencies for new institutions.* The list of serious deficiencies is not identical for each category of institution (new, renewing, participating) because the type of information likely to be available to the State agency is different, depending on whether the State agency is reviewing a new or renewing institution's application or is conducting a review of a participating institution. Serious deficiencies for new institutions are:

(A) Submission of false information on the institution's application, including but not limited to a determination that the institution has concealed a conviction for any activity that occurred during the past seven years and that indicates 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; or

(B) Any other action affecting the institution's ability to administer the Program in accordance with Program requirements.

(iii) *Serious deficiency notification procedures for new institutions.* If the State agency determines that a new institution has committed one or more serious deficiency listed in paragraph (c)(1)(ii) of this section, the State agency must use the following procedures to provide the institution and the responsible principals and responsible individuals with notice of the serious deficiency(ies) and an opportunity to take corrective action.

(A) *Notice of serious deficiency.* The State agency must notify the institution's executive director and chairman of the board of directors that the institution has been determined to be seriously deficient. The notice must identify the responsible principals and responsible individuals (e.g., for new

institutions, the person who signed the application) and must be sent to those persons as well. The State agency may specify in the notice different corrective action, and time periods for completing the corrective action, for the institution and the responsible principals and responsible individuals. At the same time the notice is issued, the State agency must add the institution to the State agency list, along with the basis for the serious deficiency determination, and provide a copy of the notice to the appropriate FNSRO. The notice must also specify:

(*1*) The serious deficiency(ies);

(*2*) The actions to be taken to correct the serious deficiency(ies);

(*3*) The time allotted to correct the serious deficiency(ies) in accordance with paragraph (c)(4) of this section.

(*4*) That the serious deficiency determination is not subject to administrative review;

(*5*) That failure to fully and permanently correct the serious deficiency(ies) within the allotted time will result in denial of the institution's application and the disqualification of the institution and the responsible principals and responsible individuals; and

(*6*) That the State agency will not pay any claims for reimbursement for eligible meals served or allowable administrative expenses incurred until the State agency has approved the institution's application and the institution has signed a Program agreement.

(B) *Successful corrective action.*

(*1*) If corrective action has been taken to fully and permanently correct the serious deficiency(ies) within the allotted time and to the State agency's satisfaction, the State agency must:

(*i*) notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the State agency has rescinded its serious deficiency determination; and

(*ii*) offer the new institution the opportunity to resubmit its application. If the new institution resubmits its application, the State agency must complete its review of the application within 30 days after receiving a complete and correct application.

(*2*) If corrective action is complete for the institution but not for all of the responsible principals and responsible individuals (or vice versa), the State agency must:

(*i*) continue with the actions (as set forth in paragraph (c)(1)(iii)(C) of this section) against the remaining parties;

(*ii*) at the same time the notice is issued, the State agency must also update the State agency list to indicate that the serious deficiency(ies) has(ve) been corrected and provide a copy of the notice to the appropriate FNSRO; and

(*iii*) if the new institution has corrected the serious deficiency(ies), offer it the opportunity to resubmit its application. If the new institution resubmits its application, the State agency must complete its review of the application within 30 days after receiving a complete and correct application.

(C) *Application denial and proposed disqualification.* If timely corrective action is not taken to fully and permanently correct the serious deficiency(ies), the State agency must notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the institution's application has been denied. At the same time the notice is issued, the State agency must also update the State agency list and provide a copy of the notice to the appropriate FNSRO. The notice must also specify:

(*1*) That the institution's application has been denied and the State agency is proposing to disqualify the institution and the responsible principals and responsible individuals;

(*2*) The basis for the actions; and

(*3*) The procedures for seeking an administrative review (in accordance with paragraph (k) of this section) of the application denial and proposed disqualifications.

(D) *Program payments.* The State agency is prohibited from paying any claims for reimbursement from a new institution for eligible meals served or allowable administrative expenses incurred until the State agency has approved its application and the institution and State agency have signed a Program agreement.

(E) *Disqualification.* When the time for requesting an administrative review expires or when the administrative review official upholds the State agency's denial and proposed disqualifications, the State agency must notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals that the institution and the responsible principal and responsible individuals have been disqualified. At the same time the notice is issued, the State agency must also update the State agency list and provide a copy of the notice and the mailing address and date of birth for each responsible principal and responsible individual to the appropriate FNSRO.

(2) *Denial of a renewing institution's application.*

(i) *General.* If a renewing institution's application does not meet all of the requirements in paragraph (b) of this section and in §§ 226.15(b) and 226.16(b), the State agency must deny the application. If, in reviewing a renewing institution's application, the State agency determines that the institution has committed one or more serious deficiency listed in paragraph (c)(2)(ii) of this section, the State agency must *initiate* action to deny the renewing institution's application and *initiate* action to disqualify the renewing institution and the responsible principals and responsible individuals.

(ii) *List of serious deficiencies for renewing institutions.* The list of serious deficiencies is not identical for each category of institution (new, renewing, participating) because the type of information likely to be available to the State agency is different, depending on whether the State agency is reviewing a new or renewing institution's application or is conducting a review of a participating institution. Serious deficiencies for renewing institutions are:

(A) Submission of false information on the institution's application, including but not limited to a determination that the institution has concealed a conviction for any activity that occurred during the past seven years and that indicates 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;

(B) Failure to operate the Program in conformance with the performance standards set forth in paragraph (b)(18) of this section;

(C) Failure to comply with the bid procedures and contract requirements of applicable Federal procurement regulations;

(D) Use of a food service management company that is in violation of health codes;

(E) Failure by a sponsoring organization of day care homes to properly classify day care homes as tier I or tier II in accordance with § 226.15(f);

(F) Failure by a sponsoring organization to properly train or monitor sponsored facilities in accordance with § 226.16(d);

(G) Failure to perform any of the other financial and administrative responsibilities required by this part;

(H) Failure to properly implement and administer the day care home termination and administrative review provisions set forth at paragraph (l) of this section and § 226.16(l); or

(I) any other action affecting the institution's ability to administer the Program in accordance with Program requirements.

(iii) *Serious deficiency notification procedures for renewing institutions.* If the State agency determines that a renewing institution has committed one or more serious deficiency listed in paragraph (c)(2)(ii) of this section, the State agency must use the following procedures to provide the institution and the responsible principals and responsible individuals notice of the serious deficiency(ies) and an opportunity to take corrective action.

(A) *Notice of serious deficiency.* The State agency must notify the institution's executive director and chairman of the board of directors that the institution has been determined to be seriously deficient. The notice must identify the responsible principals and responsible individuals and must be sent to those persons as well. The State agency may specify in the notice different corrective action, and time periods for completing the corrective action, for the institution and the responsible principals and responsible individuals. At the same time the notice is issued, the State agency must add the institution to the State agency list, along with the basis for the serious deficiency determination, and provide a copy of the notice to the appropriate FNSRO. The notice must also specify:

(*1*) The serious deficiency(ies);

(*2*) The actions to be taken to correct the serious deficiency(ies);

(*3*) The time allotted to correct the serious deficiency(ies) in accordance with paragraph (c)(4) of this section;

(*4*) That the serious deficiency determination is not subject to administrative review.

(*5*) That failure to fully and permanently correct the serious deficiency(ies) within the allotted time will result in the State agency's denial of the institution's application, the proposed termination of the institution's agreement (if the State agency has temporarily extended the agreement pursuant to paragraph (c)(2)(iii)(D) of this section) and the proposed disqualification of the institution and the responsible principals and responsible individuals; and

(*6*) That the institution's voluntary termination of its agreement with the State agency after having been notified that it is seriously deficient will still result in the instituion's formal termination by the State agency and placement of the institution and its responsible principals and responsible individuals on the National disqualified list.

(B) *Successful corrective action.*

(*1*) If corrective action has been taken to fully and permanently correct the serious deficiency(ies) within the allotted time and to the State agency's satisfaction, the State agency must:

(*i*) Notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the State agency has rescinded its serious deficiency determination; and

(*ii*) Offer the renewing institution the opportunity to resubmit its application. If the renewing institution resubmits its application, the State agency must complete its review of the application within 30 days after receiving a complete and correct application.

(*2*) If corrective action is complete for the institution but not for all of the responsible principals and responsible individuals (or vice versa), the State agency must:

(*i*) continue with the actions (as set forth in paragraph (c)(2)(iii)(C) of this section) against the remaining parties;

(*ii*) at the same time the notice is issued, the State agency must also update the State agency list to indicate that the serious deficiency(ies) has(ve) been corrected and provide a copy of the notice to the appropriate FNSRO; and

(*iii*) if the renewing institution has corrected the serious deficiency(ies), offer it the opportunity to resubmit its application. If the renewing institution resubmits its application, the State agency must complete its review of the application within 30 days after receiving a complete and correct application.

(C) *Application denial and proposed disqualification.* If timely corrective action is not taken to fully and permanently correct the serious deficiency(ies), the State agency must notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the institution's application has been denied. At the same time the notice is issued, the State agency must update the State agency list and provide a copy of the notice to the appropriate FNSRO. The notice must also specify:

(*1*) That the institution's application has been denied and the State agency is proposing to terminate the institution's temporarily-extended agreement and to disqualify the institution and the responsible principals and responsible individuals;

(*2*) The basis for the actions;

(*3*) That, if the institution voluntarily terminates its agreement after receiving the notice of the proposed termination, the institution and the responsible principals and responsible individuals will be disqualified;

(*4*) The procedures for seeking an administrative review (in accordance with paragraph (k) of this section) of the application denial and proposed disqualifications; and

(*5*) That the institution may continue to participate in the Program and receive Program reimbursement for eligible meals served and allowable administrative costs incurred until its administrative review is completed.

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

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

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

(E) *Agreement termination and disqualification.* When the time for requesting an administrative review expires or when the administrative review official upholds the State agency's denial of the institution's application, the proposed termination, and the proposed disqualifications, the State agency must:

(*1*) Notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the temporarily-extended agreement has been terminated and that the institution and the responsible principals and responsible individuals have been disqualified;

(*2*) Update the State agency list at the time such notice is issued; and

(*3*) Provide a copy of the notice and the mailing address and date of birth for each responsible principal and responsible individual to the appropriate FNSRO.

(3) *Termination of a participating institution's agreement.* (i) *General.* If the State agency holds an agreement with an institution operating in more than one State that has been disqualified from the Program by another State agency and placed on the National disqualified list, the State agency must terminate the institution's agreement effective no later than 45 days of the date of the institution's disqualification by the other State agency. At the same time the notice of termination is issued, the State agency must add the institution to the State agency list and indicate that the institution's agreement has been terminated and provide a copy of the notice to the appropriate FNSRO. If the State agency determines that a participating institution has committed one or more serious deficiency listed in paragraph (c)(3)(ii) of this section, the State agency must *initiate* action to terminate the agreement of a participating institution and *initiate* action to disqualify the institution and any responsible principals and responsible individuals.

(ii) *List of serious deficiencies for participating institutions.* The list of serious deficiencies is not identical for each category of institution (new, renewing, participating) because the type of information likely to be available to the State agency is different, depending on whether the State agency is reviewing a new or renewing institution's application or is conducting a review of a participating institution. Serious deficiencies for participating institutions are:

(A) Submission of false information on the institution's application, including but not limited to a determination that the institution has concealed a conviction for any activity that occurred during the past seven years and that indicates 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;

(B) Permitting an individual who is on the National disqualified list to serve in a principal capacity with the institution or, if a sponsoring organization, permitting such an individual to serve as a principal in a sponsored center or as a day care home;

(C) Failure to operate the Program in conformance with the performance standards set forth in paragraph (b)(18) of this section;

(D) Failure to comply with the bid procedures and contract requirements of applicable Federal procurement regulations;

(E) Failure to return to the State agency any advance payments that exceeded the amount earned for serving eligible meals, or failure to return disallowed start-up or expansion payments;

(F) Failure to maintain adequate records;

(G) Failure to adjust meal orders to conform to variations in the number of participants;

(H) Claiming reimbursement for meals not served to participants;

(I) Claiming reimbursement for a significant number of meals that do not meet Program requirements;

(J) Use of a food service management company that is in violation of health codes;

(K) Failure of a sponsoring organization to disburse payments to its facilities in accordance with the regulations at § 226.16(g) and (h) or in accordance with its management plan;

(L) Claiming reimbursement for meals served by a proprietary title XX child care center during a calendar month in which less than 25 percent of its enrolled children, or 25 percent of its licensed capacity, whichever is less, were title XX beneficiaries;

(M) Claiming reimbursement for meals served by a proprietary title XIX or title XX adult day care center during a calendar month in which less than 25 percent of its enrolled adult participants were title XIX or title XX beneficiaries;

(N) Failure by a sponsoring organization of day care homes to properly classify day care homes as tier I or tier II in accordance with § 226.15(f);

(O) Failure by a sponsoring organization to properly train or monitor sponsored facilities in accordance with § 226.16(d);

(P) Use of day care home funds by a sponsoring organization to pay for the sponsoring organization's administrative expenses;

(Q) Failure to perform any of the other financial and administrative responsibilities required by this part;

(R) Failure to properly implement and administer the day care home termination and administrative review provisions set forth at paragraph (l) of this section and § 226.16(l);

(S) The fact the institution or any of the institution's 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 is now eligible to participate in, that program, including the payment of any debts owed;

(T) Conviction of the institution or any of its principals for any activity that occurred during the past seven years and that indicates 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; or

(U) Any other action affecting the institution's ability to administer the Program in accordance with Program requirements.

(iii) *Serious deficiency notification procedures for participating institutions.* If the State agency determines that a participating institution has committed one or more serious deficiency listed in paragraph (c)(3)(ii) of this section, the State agency must use the following procedures to provide the institution and the responsible principals and responsible individuals notice of the serious deficiency(ies) and an opportunity to take corrective action. However, if the serious deficiency(ies) constitutes an imminent threat to the health or safety of participants, or the institution has engaged in activities that threaten the public health or safety, the State agency must follow the procedures in paragraph (c)(5)(i) of this section instead of the procedures below. Further, if the serious deficiency is the submission of a false or fraudulent claim, in addition to the procedures below, the State agency may suspend the institution's participation in accordance with paragraph (c)(5)(ii) of this section.

(A) *Notice of serious deficiency.* The State agency must notify the institution's executive director and chairman of the board of directors that the institution has been determined seriously deficient. The notice must identify the responsible principals and responsible individuals and must be sent to those persons as well. The State agency may specify in the notice different corrective action and time periods for completing the corrective action for the institution and the responsible principals and responsible individuals. At the same time the notice is issued, the State agency must add the institution to the State agency list, along with the basis for the serious deficiency determination, and provide a copy of

the notice to the appropriate FNSRO. The notice must also specify:

(*1*) The serious deficiency(ies);

(*2*) The actions to be taken to correct the serious deficiency(ies);

(*3*) The time allotted to correct the serious deficiency(ies) in accordance with paragraph (c)(4) of this section;

(*4*) That the serious deficiency determination is not subject to administrative review.

(*5*) That failure to fully and permanently correct the serious deficiency(ies) within the allotted time will result in the State agency's proposed termination of the institution's agreement and the proposed disqualification of the institution and the responsible principals and responsible individuals; and

(*6*) That the institution's voluntary termination of its agreement with the State agency after having been notified that it is seriously deficient will still result in the instituion's formal termination by the State agency and placement of the institution and its responsible principals and responsible individuals on the National disqualified list.

(B) *Successful corrective action.*

(*1*) If corrective action has been taken to fully and permanently correct the serious deficiency(ies) within the allotted time and to the State agency's satisfaction, the State agency must:

(*i*) Notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the State agency has rescinded its serious deficiency determination; and

(*ii*) Offer the renewing institution the opportunity to resubmit its application. If the renewing institution resubmits its application, the State agency must complete its review of the application within 30 days after receiving a complete and correct application.

(*2*) If corrective action is complete for the institution but not for all of the responsible principals and responsible individuals (or vice versa), the State agency must:

(*i*) Continue with the actions (as set forth in paragraph (c)(3)(iii)(C) of this section) against the remaining parties;

(*ii*) At the same time the notice is issued, the State agency must also update the State agency list to indicate that the serious deficiency(ies) has(ve) been corrected and provide a copy of the notice to the appropriate FNSRO; and

(*iii*) If the renewing institution has corrected the serious deficiency(ies), offer it the opportunity to resubmit its application. If the renewing institution resubmits its application, the State agency must complete its review of the application within 30 days after receiving a complete and correct application.

(C) *Proposed termination and proposed disqualification.* If timely corrective action is not taken to fully and permanently correct the serious deficiency(ies), the State agency must notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the State agency is proposing to terminate the institution's agreement and to disqualify the institution and the responsible principals and responsible individuals. At the same time the notice is issued, the State agency must also update the State agency list and provide a copy of the notice to the appropriate FNSRO. The notice must also specify:

(*1*) That the State agency is proposing to terminate the institution's agreement and to disqualify the institution and the responsible principals and responsible individuals;

(*2*) The basis for the actions;

(*3*) That, if the institution voluntarily terminates its agreement after receiving the notice of proposed termination, the institution and the responsible principals and responsible individuals will be disqualified.

(*4*) The procedures for seeking an administrative review (in accordance with paragraph (k) of this section) of the application denial and proposed disqualifications; and

(*5*) That, unless participation has been suspended, the institution may continue to participate and receive Program reimbursement for eligible meals served and allowable administrative costs incurred until its administrative review is completed.

(D) *Program payments.* Unless participation has been suspended, the State agency must continue to pay any valid unpaid claims for reimbursement for eligible meals served and allowable administrative expenses incurred until the serious deficiency(ies) is corrected or the institution's agreement is terminated, including the period of any administrative review.

(E) *Agreement termination and disqualification.* When the time for requesting an administrative review expires or when the administrative review official upholds the State agency's proposed termination and disqualifications, the State agency must:

(*1*) Notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the institution's agreement has been terminated and that the institution and the responsible principals and responsible individuals have been disqualified;

(*2*) Update the State agency list at the time such notice is issued; and

(*3*) Provide a copy of the notice and the mailing address and date of birth for each responsible principal and responsible individual to the appropriate FNSRO.

(4) *Corrective action timeframes.*

(i) *General.* Except as noted in this paragraph (c)(4), the State agency is prohibited from allowing more than 90 days for corrective action from the date the institution receives the serious deficiency notice.

(ii) *Unlawful practices.* If the State agency determines that the institution has engaged in unlawful practices, submitted false or fraudulent claims or other information to the State agency, or been convicted of or concealed a criminal background, the State agency is prohibited from allowing more than 30 days for corrective action.

(iii) *Long-term changes.* For serious deficiencies requiring the long-term revision of management systems or processes, the State agency may permit more than 90 days to complete the corrective action as long as a corrective action plan is submitted to and approved by the State agency within 90 days (or such shorter deadline as the State agency may establish). The corrective action must include milestones and a definite completion date that the State agency will monitor. The determination of serious deficiency will remain in effect until the State agency determines that the serious deficiency(ies) has(ve) been fully and permanently corrected within the allotted time.

(5) *Suspension of an institution's participation.* A State agency is prohibited from suspending an institution's participation (including all Program payments) except for the reasons set forth in this paragraph (c)(5).

(i) *Public health or safety.*

(A) *General.* If State or local health or licensing officials have cited an institution for serious health or safety violations, the State agency must immediately suspend the institution's Program participation, initiate action to terminate the institution's agreement, and initiate action to disqualify the institution and the responsible principals and responsible individuals prior to any formal action to revoke the institution's licensure or approval. If the State agency determines that there is an imminent threat to the health or safety of participants at an institution, or that the institution has engaged in activities that threaten the public health or safety,

the State agency must immediately notify the appropriate State or local licensing and health authorities and take action that is consistent with the recommendations and requirements of those authorities. An imminent threat to the health or safety of participants and engaging in activities that threaten the public health or safety constitute serious deficiencies; however, the State agency must use the procedures in this paragraph (c)(5)(i) (instead of the procedures in paragraph (c)(3) of this section) to provide the institution notice of the suspension of participation, serious deficiency, proposed termination of the institution's agreement, and proposed disqualification of the responsible principals and responsible individuals.

(B) *Notice of suspension, serious deficiency, proposed termination, and proposed disqualification.* The State agency must notify the institution's executive director and chairman of the board of directors that the institution's participation (including Program payments) has been suspended, that the institution has been determined to be seriously deficient, and that the State agency proposes to terminate the institution's agreement and to disqualify the institution and the responsible principals and responsible individuals. The notice must also identify the responsible principals and responsible individuals and must be sent to those persons as well. At the same time this notice is sent, the State agency must add the institution and the responsible principals and responsible individuals to the State agency list, along with the basis for the serious deficiency determination and provide a copy of the notice to the appropriate FNSRO. The notice must also specify:

(*1*) That the State agency is suspending the institution's participation (including Program payments), proposing to terminate the institution's agreement, and proposing to disqualify the institution and the responsible principals and responsible individuals;

(*2*) The serious deficiency(ies);

(*3*) That, if the institution voluntary terminates its agreement with the State agency after having been notified of the proposed termination, the institution and the responsible principals and responsible individuals will be disqualified;

(*4*) That the serious deficiency determination is not subject to administrative review;

(*5*) The procedures for seeking an administrative review (consistent with paragraph (k) of this section) of the suspension, proposed termination, and proposed disqualifications; and

(*6*) That, if the administrative review official overturns the suspension, the institution may claim reimbursement for eligible meals served and allowable administrative costs incurred during the suspension period.

(C) *Agreement termination and disqualification.* When the time for requesting an administrative review expires or when the administrative review official upholds the State agency's proposed termination and disqualifications, the State agency must:

(*1*) Notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the institution's agreement has been terminated and that the institution and the responsible principals and responsible individuals have been disqualified;

(*2*) update the State agency list at the time such notice is issued; and

(*3*) provide a copy of the notice and the mailing address and date of birth for each responsible principal and responsible individual to the appropriate FNSRO.

(D) *Program payments.* The State agency is prohibited from paying any claims for reimbursement from a suspended institution. However, if the suspended institution prevails in the administrative review of the proposed termination, the State agency must pay any claims for reimbursement for eligible meals served and allowable administrative costs incurred during the suspension period.

(ii) *False or fraudulent claims.*

(A) *General.* If the State agency determines that an institution has knowingly submitted a false or fraudulent claim, the State agency *may* initiate action to suspend the institution's participation and must *initiate* action to terminate the institution's agreement and initiate action to disqualify the institution and the responsible principals and responsible individuals (in accordance with paragraph (c)(3) of this section). The submission of a false or fraudulent claim constitutes a serious deficiency as set forth in paragraph (c)(3)(ii) of this section, which lists serious deficiencies for participating institutions. If the State agency wishes to suspend the institution's participation, it must use the following procedures to issue the notice of proposed suspension of participation *at the same time* it issues the serious deficiency notice, which must include the information described in paragraph (c)(3)(iii)(A) of this section.

(B) *Proposed suspension of participation.* If the State agency decides to propose to suspend an institution's participation due to the institution's submission of a false or fraudulent claim, it must notify the institution's executive director and chairman of the board of directors that the State agency intends to suspend the institution's participation (including all Program payments) unless the institution requests a review of the proposed suspension. At the same time the notice is issued, the State agency must also update the State agency list and provide a copy of the notice to the appropriate FNSRO. The notice must identify the responsible principals and responsible individuals and must be sent to those persons as well. The notice must also specify:

(*1*) That the State agency is proposing to suspend the institution's participation;

(*2*) That the proposed suspension is based on the institution's submission of a false or fraudulent claim, as described in the serious deficiency notice;

(*3*) The effective date of the suspension (which may be no earlier than 10 days after the institution receives the suspension notice);

(*4*) The name, address and telephone number of the suspension review official who will conduct the suspension review; and

(*5*) That if the institution wishes to have a suspension review, it must request a review and submit to the suspension review official written documentation opposing the proposed suspension within 10 days of the institution's receipt of the notice.

(C) *Suspension review.* If the institution requests a review of the State agency's proposed suspension of participation, the suspension review must be heard by a suspension review official who must:

(1) Be an independent and impartial person other than, and not accountable to, any person involved in the decision to initiate suspension proceedings;

(2) Immediately notify the State agency that the institution has contested the proposed suspension and must obtain from the State agency its notice of proposed suspension of participation, along with all supporting documentation; and

(3) Render a decision on suspension of participation within 10 days of the deadline for receiving the institution's documentation opposing the proposed suspension.

(D) *Suspension review decision.* If the suspension review official determines that the State agency's proposed suspension is not appropriate, the State

agency is prohibited from suspending participation. If the suspension review official determines, based on a preponderance of the evidence, that the State agency's action was appropriate, the State agency must suspend the institution's participation (including all Program payments), effective on the date of the suspension review decision. The State agency must notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the institution's participation has been suspended. At the same time the notice is issued, the State agency must also update the State agency list and provide a copy of the notice to the appropriate FNSRO. The notice must also specify:

(*1*) That the State agency is suspending the institution's participation (including Program payments);

(*2*) The effective date of the suspension (the date of the suspension review decision);

(*3*) The procedures for seeking an administrative review (in accordance with paragraph (k) of this section) of the suspension; and

(*4*) That if the administrative review official overturns the suspension, the institution may claim reimbursement for eligible meals served and allowable administrative costs incurred during the suspension period.

(E) *Program payments.* A State agency is prohibited from paying any claims for reimbursement submitted by a suspended institution. However, if the institution suspended for the submission of false or fraudulent claims is a sponsoring organization, the State agency must ensure that sponsored facilities continue to receive reimbursement for eligible meals served during the suspension period. If the suspended institution prevails in the administrative review of the proposed termination, the State agency must pay any valid unpaid claims for reimbursement for eligible meals served and allowable administrative costs incurred during the suspension period.

(F) *Maximum time for suspension.* Under no circumstances may the suspension of participation remain in effect for more than 120 days following the suspension review decision.

(6) *FNS determination of serious deficiency.* (i) *General.* FNS may determine independently that a participating institution has committed one or more serious deficiency listed in paragraph (c)(3)(ii) of this section, which lists serious deficiencies for participating institutions.

(ii) *Serious deficiency notification procedures.* If FNS determines that an institution has committed one or more serious deficiency listed in paragraph (c)(3)(ii) of this section (the list of serious deficiencies for participating institutions), FNS will use the following procedures to provide the institution and the responsible principals and responsible individuals with notice of the serious deficiency(ies) and an opportunity to take corrective action.

(A) *Notice of serious deficiency.* FNS will notify the institution's executive director and chairman of the board of directors that the institution has been found to be seriously deficient. The notice will identify the responsible principals and responsible individuals and will be sent to them as well. FNS may specify in the notice different corrective action and time periods for completing the corrective action, for the institution and the responsible principals and responsible individuals. The notice will also specify:

(*1*) The serious deficiency(ies);

(*2*) The actions to be taken to correct the serious deficiency(ies);

(*3*) The time allotted to correct the serious deficiency(ies) in accordance with paragraph (c)(4) of this section;

(*4*) That failure to fully and permanently correct the serious deficiency(ies) within the allotted time, or the institution's voluntary termination of its agreement(s) with any State agency after having been notified that it is seriously deficient, will result in the proposed disqualification of the institution and the responsible principals and responsible individuals and the termination of its agreement(s) with all State agencies; and

(*5*) That the serious deficiency determination is not subject to administrative review.

(B) *Suspension of participation.* If FNS determines that there is an imminent threat to the health or safety of participants at an institution, or that the institution has engaged in activities that threaten the public health or safety, any State agency that holds an agreement with the institution must suspend the participation of the institution. If FNS determines that the institution has submitted a false or fraudulent claim, it may require any State agency that holds an agreement with the institution to initiate action to suspend the institution's participation for false or fraudulent claims in accordance with paragraph (c)(5)(ii) of this section (which deals with an institution's suspension by a State agency for submission of false or fraudulent claims). In both cases, FNS will provide the State agency the information necessary to support these actions and, in the case of a false and fraudulent claim, will provide an individual to serve as the suspension review official if requested by the State agency.

(C) *Successful corrective action.*

(*1*) If corrective action has been taken to fully and permanently correct the serious deficiency(ies) within the allotted time and to FNS's satisfaction, FNS will notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that it has rescinded its serious deficiency determination; and

(*2*) If corrective action is complete for the institution but not for all of the responsible principals and responsible individuals (or vice versa), FNS will continue with the actions (as set forth in paragraph (c)(6)(ii)(D) of this section) against the remaining parties.

(D) *Proposed disqualification.* If timely corrective action is not taken to fully and permanently correct the serious deficiency(ies), FNS will notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that FNS is proposing to disqualify them. The notice will also specify:

(*1*) That FNS is proposing to disqualify the institution and the responsible principals and responsible individuals;

(*2*) The basis for the actions;

(*3*) That, if the institution seeks to voluntarily terminate its agreement after receiving the notice of proposed disqualification, the institution and the responsible principals and responsible individuals will be disqualified;

(*4*) The procedures for seeking an administrative review (in accordance with paragraph (k) of this section) of the proposed disqualifications;

(*5*) That unless participation has been suspended, the institution may continue to participate and receive Program reimbursement for eligible meals served and allowable administrative costs incurred until its administrative review is completed; and

(*6*) That if the institution does not prevail in the administrative review, any State agency holding an agreement with the institution will be required to terminate that agreement and the institution is prohibited from seeking an administrative review of the termination of the agreement by the State agency(ies).

(E) *Disqualification.* When the time for requesting an administrative review expires or when the administrative review official upholds FNS's proposed

disqualifications, FNS will notify the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, that the institution and the responsible principal or responsible individual have been disqualified.

(F) *Program payments.* If the State agency holds an agreement with an institution that FNS has determined to be seriously deficient, the State agency must continue to pay any valid unpaid claims for reimbursement for eligible meals served and allowable administrative expenses incurred until the serious deficiency(ies) is corrected or the State agency terminates the institution's agreement, including the period of any administrative review, unless participation has been suspended.

(G) *Required State agency action.* (*1*) *Disqualified institutions.* If the State agency holds an agreement with an institution that FNS determines to be seriously deficient and subsequently disqualifies, the State agency must terminate the institution's agreement effective no later than 45 days after the date of the institution's disqualification by FNS. As noted in paragraph (k)(3)(iv) of this section, the termination is not subject to administrative review. At the same time the notice of termination is issued, the State agency must add the institution to the State agency list and provide a copy of the notice to the appropriate FNSRO.

(*2*) *Disqualified principals.* If the State agency holds an agreement with an institution whose principal FNS determines to be seriously deficient and subsequently disqualifies, the State agency must determine the institution to be seriously deficient and initiate action to terminate and disqualify the institution in accordance with the procedures in paragraph (c)(3) of this section. The State agency must initiate these actions no later than 45 days after the date of the principal's disqualification by FNS.

(*7*) *National disqualified list.*

(i) *Maintenance and availability of list.* FNS will maintain the National disqualified list and make it available to all State agencies and all sponsoring organizations.

(ii) *Effect on institutions.* No organization on the National disqualified list may participate in the Program as an institution. As noted in paragraph (b)(12) of this section, the State agency must deny the application of a new or renewing institution if the institution is on the National disqualified list. In addition, as noted in paragraphs (c)(3)(i) and (c)(6)(ii)(G)(*1*) of this section, the State agency must terminate the agreement of any participating institution that is disqualified by another State agency or by FNS.

(iii) *Effect on sponsored centers.* No organization on the National disqualified list may participate in the Program as a sponsored center. As noted in § 226.16(b) and paragraph (b)(12) of this section, a sponsoring organization is prohibited from submitting an application on behalf of a sponsored facility (and a State agency is prohibited from approving such an application) if the facility is on the National disqualified list.

(iv) *Effect on individuals.* No individual on the National disqualified list may serve as a principal in any institution or facility or as a day care home provider.

(A) *Principal for an institution or a sponsored facility.* As noted in paragraph (b)(12) of this section, the State agency must deny the application of a new or renewing institution if any of the institution's principals is on the National disqualified list. As noted in paragraphs (c)(3)(ii)(B) and (c)(6)(ii)(G)(*2*) of this section, the State agency must declare an institution seriously deficient and initiate action to terminate the institution's agreement and disqualify the institution if the institution permits an individual who is on the National disqualified list to serve in a principal capacity for the institution or one of its facilities.

(B) *Principal for a sponsored facility.* As noted in § 226.16(b) and paragraph (b)(12) of this section, a sponsoring organization is prohibited from submitting an application on behalf of a sponsored facility (or a State agency from approving such an application) if any of the facility's principals are on the National disqualified list.

(C) *Serving as a day care home.* As noted in § 226.16(b) and paragraph (b)(12) of this section, a sponsoring organization is prohibited from submitting an application on behalf of a sponsored facility (and a State agency is prohibited from approving such an application) if the facility is on the National disqualified list.

(v) *Removal of institutions, principals, and individuals from the list.* Once included on the National disqualified list, an institution and responsible principals and responsible individuals remain on the list until such time as FNS, in consultation with the appropriate State agency, determines that the serious deficiency(ies) that led to their placement on the list has(ve) been corrected, or until seven years have elapsed since they were disqualified from participation. However, if the institution, principal or individual has failed to repay debts owed under the Program, they will remain on the list until the debt has been repaid.

(vi) *Removal of day care homes from the list.* Once included on the National disqualified list, a day care home will remain on the list until such time as the State agency determines that the serious deficiency(ies) that led to its placement on the list has(ve) been corrected, or until seven years have elapsed since its agreement was terminated for cause. However, if the day care home has failed to repay debts owed under the Program, it will remain on the list until the debt has been repaid.

(8) *State agency list.* (i) *Maintenance of the State agency list.* The State agency must maintain a State agency list (in the form of an actual paper or electronic list or retrievable paper records). The list must be made available to FNS upon request, and must include the following information:

(A) Institutions determined to be seriously deficient by the State agency, including the names and mailing addresses of the institutions and the status of the institutions as they move through the possible subsequent stages of corrective action, proposed termination, suspension, agreement termination, and/or disqualification, as applicable;

(B) Responsible principals and individuals who have been disqualified from participation by the State agency, including their names, mailing addresses, and dates of birth; and

(C) Day care home providers whose agreements have been terminated for cause by a sponsoring organization in the State, including their names, mailing addresses, and dates of birth.

(ii) *Referral of disqualified day care homes to FNS.* Within 10 days of receiving a notice of termination and disqualification from a sponsoring organization, the State agency must provide the appropriate FNSRO the name, mailing address, and date of birth of each day care home provider whose agreement is terminated for cause on or after July 29, 2002.

(iii) *Prior lists of disqualified day care homes.* If on July 29, 2002 the State agency maintains a list of day care homes that have been disqualified from participation, the State agency may continue to prohibit participation by those day care homes. However, the State agency must remove a day care home from its prior list no later than the time at which the State agency determines that the serious deficiency(ies) that led to the day care

home's placement on the list has(ve) been corrected or July 29, 2009 (unless the day care home has failed to repay debts owed under the Program). If the day care home has failed to repay its debt, the State agency may keep the day care home on its prior list until the debt has been repaid.

* * * * *

(f) * * *

(1) * * * 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.

(2) * * * The State agency must establish factors, consistent with § 226.16(b)(1), that the State agency will consider in determining whether a sponsoring organization has sufficient staff to perform required monitoring responsibilities at all of its sponsored facilities. As part of its review of the 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 in § 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. The State agency must ensure that each currently participating sponsoring organization meets this requirement no later than July 29, 2003.

(3) * * * For a sponsoring organization 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 that 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) *Administrative reviews for institutions and responsible principals and responsible individuals.*

(1) *General.* The State agency must develop procedures for offering administrative reviews to institutions and responsible principals and responsible individuals. The procedures must be consistent with paragraph (k) of this section.

(2) *Actions subject to administrative review.* Except as provided in § 226.8(g), the State agency must offer an administrative review for the following actions:

(i) *Application denial.* Denial of a new or renewing institution's application for participation (see paragraph (b) of this section, on State agency review of an institution's application; and paragraphs (c)(1) and (c)(2) of this section, on State agency denial of a new or renewing institution's application);

(ii) *Denial of sponsored facility application.* Denial of an application submitted by a sponsoring organization on behalf of a facility;

(iii) *Notice of proposed termination.* Proposed termination of an institution's agreement (see paragraphs (c)(2)(iii)(C), (c)(3)(iii)(C), and (c)(5)(i)(B) of this section, dealing with proposed termination of agreements with renewing institutions, participating institutions, and participating institutions suspended for health or safety violations);

(iv) *Notice of proposed disqualification of a responsible principal or responsible individual.* Proposed disqualification of a responsible principal or responsible individual (see paragraphs (c)(1)(iii)(C), (c)(2)(iii)(C), (c)(3)(iii)(C), and (c)(5)(i)(B) of this section, dealing with proposed disqualification of responsible principals or responsible individuals in new, renewing, and participating institutions, and participating institutions suspended for health or safety violations);

(v) *Suspension of participation.* Suspension of an institution's participation (see paragraphs (c)(5)(i)(B) and (c)(5)(ii)(D) of this section, dealing with suspension for health or safety reasons or submission of a false or fraudulent claim);

(vi) *Start-up or expansion funds denial.* Denial of an institution's application for start-up or expansion payments (see § 226.7(h));

(vii) *Advance denial.* Denial of a request for an advance payment (see § 226.10(b));

(viii) *Recovery of advances.* Recovery of all or part of an advance in excess of the claim for the applicable period. The recovery may be through a demand for full repayment or an adjustment of subsequent payments (see § 226.10(b)(3));

(ix) *Claim denial.* Denial of all or a part of an institution's claim for reimbursement (except for a denial based on a late submission under § 226.10(e)) (see §§ 226.10(f) and 226.14(a));

(x) *Claim deadline exceptions and requests for upward adjustments to a claim.* Decision by the State agency not to forward to FNS an exception request by an institution for payment of a late claim, or a request for an upward adjustment to a claim (see § 226.10(e));

(xi) *Overpayment demand.* Demand for the remittance of an overpayment (see § 226.14(a)); and

(xii) *Other actions.* Any other action of the State agency affecting an institution's participation or its claim for reimbursement.

(3) *Actions not subject to administrative review.* The State agency is prohibited from offering administrative reviews of the following actions:

(i) *FNS decisions on claim deadline exceptions and requests for upward adjustments to a claim.* A decision by FNS to deny an exception request by an institution for payment of a late claim, or for an upward adjustment to a claim (see § 226.10(e));

(ii) *Determination of serious deficiency.* A determination that an institution is seriously deficient (see paragraphs (c)(1)(iii)(A), (c)(2)(iii)(A), (c)(3)(iii)(A), and (c)(5)(i)(B) of this section, dealing with proposed disqualification of responsible principals or responsible individuals in new, renewing, and participating institutions, and participating institutions suspended for health or safety violations);

(iii) *Disqualification and placement on State agency list and National disqualified list.* Disqualification of an institution or a responsible principal or responsible individual, and the subsequent placement on the State agency list and the National disqualified list (see paragraphs (c)(1)(iii)(E), (c)(2)(iii)(E), (c)(3)(iii)(E), and (c)(5)(i)(C) of this section, dealing with proposals to disqualify related to new, renewing, and participating institutions, and in institutions suspended for health or safety violations); or

(iv) *Termination.* Termination of a participating institution's agreement, including termination of a participating institution's agreement based on the

disqualification of the institution by another State agency or FNS (see paragraphs (c)(3)(i) and (c)(7)(ii) of this section).

(4) *Provision of administrative review procedures to institutions and responsible principals and responsible individuals.* The State agency's administrative review procedures must be provided:

(i) Annually to all institutions;

(ii) To an institution and to each responsible principal and responsible individual when the State agency takes any action subject to an administrative review as described in paragraph (k)(2) of this section; and

(iii) Any other time upon request.

(5) *Procedures.* Except as described in paragraph (k)(9) of this section, which sets forth the circumstances under which an abbreviated administrative review is held, the State agency must follow the procedures in this paragraph (k)(5) when an institution or a responsible principal or responsible individual appeals any action subject to administrative review as described in paragraph (k)(2) of this section.

(i) *Notice of action.* The institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, must be given notice of the action being taken or proposed, the basis for the action, and the procedures under which the institution and the responsible principals or responsible individuals may request an administrative review of the action.

(ii) *Time to request administrative review.* The request for administrative review must be submitted in writing not later than 15 days after the date the notice of action is received, and the State agency must acknowledge the receipt of the request for an administrative review within 10 days of its receipt of the request.

(iii) *Representation.* The institution and the responsible principals and responsible individuals may retain legal counsel, or may be represented by another person.

(iv) *Review of record.* Any information on which the State agency's action was based must be available to the institution and the responsible principals and responsible individuals for inspection from the date of receipt of the request for an administrative review.

(v) *Opposition.* The institution and the responsible principals and responsible individuals may refute the findings contained in the notice of action in person or by submitting written documentation to the administrative review official. In order to be considered, written documentation must be submitted to the administrative review official not later than 30 days after receipt of the notice of action.

(vi) *Hearing.* A hearing must be held by the administrative review official in addition to, or in lieu of, a review of written information only if the institution or the responsible principals and responsible individuals request a hearing in the written request for an administrative review. If the institution's representative, or the responsible principals or responsible individuals or their representative, fail to appear at a scheduled hearing, they waive the right to a personal appearance before the administrative review official, unless the administrative review official agrees to reschedule the hearing. A representative of the State agency must be allowed to attend the hearing to respond to the testimony of the institution and the responsible principals and responsible individuals and to answer questions posed by the administrative review official. If a hearing is requested, the institution, the responsible principals and responsible individuals, and the State agency must be provided with at least 10 days advance notice of the time and place of the hearing.

(vii) *Administrative review official.* The administrative review official must be independent and impartial. This means that, although the administrative review official may be an employee of the State agency, he/she must not have been involved in the action that is the subject of the administrative review, or have a direct personal or financial interest in the outcome of the administrative review. The institution and the responsible principals and responsible individuals must be permitted to contact the administrative review official directly if they so desire.

(viii) *Basis for decision.* The administrative review official must make a determination based solely on the information provided by the State agency, the institution, and the responsible principals and responsible individuals, and based on Federal and State laws, regulations, policies, and procedures governing the Program.

(ix) *Time for issuing a decision.* Within 60 days of the State agency's receipt of the request for an administrative review, the administrative review official must inform the State agency, the institution's executive director and chairman of the board of directors, and the responsible principals and responsible individuals, of the administrative review's outcome. This timeframe is an administrative requirement for the State agency and may not be used as a basis for overturning the State agency's action if a decision is not made within the specified timeframe.

(x) *Final decision.* The determination made by the administrative review official is the final administrative determination to be afforded the institution and the responsible principals and responsible individuals.

(6) *Federal audit findings.* FNS may assert a claim against the State agency, in accordance with the procedures set forth in § 226.14(c), when an administrative review results in the dismissal of a claim against an institution asserted by the State agency based upon Federal audit findings.

(7) *Record of result of administrative reviews.* The State agency must maintain searchable records of all administrative reviews and their disposition.

(8) *Combined administrative reviews for responsible principals and responsible individuals.* The State agency must conduct the administrative review of the proposed disqualification of the responsible principals and responsible individuals as part of the administrative review of the application denial, proposed termination, and/or proposed disqualification of the institution with which the responsible principals or responsible individuals are associated. However, at the administrative review official's discretion, separate administrative reviews may be held if the institution does not request an administrative review or if either the institution or the responsible principal or responsible individual demonstrates that their interests conflict.

(9) *Abbreviated administrative review.* The State agency must limit the administrative review to a review of written submissions concerning the accuracy of the State agency's determination if the application was denied or the State agency proposes to terminate the institution's agreement because:

(i) The information submitted on the application was false (see paragraphs (c)(1)(ii)(A), (c)(2)(ii)(A), and (c)(3)(ii)(A) of this section);

(ii) The institution, one of its sponsored facilities, or one of the principals of the institution or its facilities is on the national disqualified list (see paragraph (b)(12) of this section);

(iii) The institution, one of its sponsored facilities, or one of the principals of the institution or its facilities is ineligible to participate in any other publicly funded program by reason of violation of the requirements

of the program (see paragraph (b)(13) and (c)(3)(ii)(S) of this section); or

(iv) The institution, one of its sponsored facilities, or one of the principals of the institution or its facilities has been convicted for any activity that indicates a lack of business integrity (see paragraphs (b)(14) and (c)(3)(ii)(T) of this section).

(10) *Effect of State agency action.* The State agency's action must remain in effect during the administrative review. The effect of this requirement on particular State agency actions is as follows.

(i) *Overpayment demand.* During the period of the administrative review, the State agency is prohibited from taking action to collect or offset the overpayment. However, the State agency must assess interest beginning with the initial demand for remittance of the overpayment and continuing through the period of administrative review unless the administrative review official overturns the State agency's action.

(ii) *Recovery of advances.* During the administrative review, the State agency must continue its efforts to recover advances in excess of the claim for reimbursement for the applicable period. The recovery may be through a demand for full repayment or an adjustment of subsequent payments.

(iii) *Program payments.* The availability of Program payments during an administrative review of the denial of a new institution's application, denial of a renewing institution's application, proposed termination of a participating institution's agreement, and suspension of an institution are addressed in paragraphs (c)(1)(iii)(D), (c)(2)(iii)(D), (c)(3)(iii)(D), (c)(5)(i)(D), and (c)(5)(ii)(E), respectively, of this section.

(l) *Administrative reviews for day care homes.*

(1) *General.* The State agency must ensure that, when a sponsoring organization proposes to terminate its Program agreement with a day care home for cause, the day care home is provided an opportunity for an administrative review of the proposed termination. The State agency may do this either by electing to offer a State-level administrative review, or by electing to require the sponsoring organization to offer an administrative review. The State agency must notify the appropriate FNSRO of its election under this option, or any change it later makes under this option, by September 25, 2002 or within 30 days of any subsequent change under this option. The State agency must make the same election with regard to who offers the administrative review to any day care home in the Program in that State. The State agency or the sponsoring organization must develop procedures for offering and providing these administrative reviews, and these procedures must be consistent with this paragraph (l).

(2) *Actions subject to administrative review.* The State agency or sponsoring organization must offer an administrative review to a day care home that appeals a notice of intent to terminate their agreement for cause or a suspension of their participation (see §§ 226.16(l)(3)(iii) and (l)(4)(ii)).

(3) *Actions not subject to administrative review.* Neither the State agency nor the sponsoring organization is required to offer an administrative review for reasons other than those listed in paragraph (l)(2) of this section.

(4) *Provision of administrative review procedures to day care homes.* The administrative review procedures must be provided:

(i) Annually to all day care homes;

(ii) To a day care home when the sponsoring organization takes any action subject to an administrative review as described in paragraph (l)(2) of this section; and

(iii) Any other time upon request.

(5) *Procedures.* The State agency or sponsoring organization, as applicable (depending on the State agency's election pursuant to paragraph (l)(1) of this section) must follow the procedures in this paragraph (l)(5) when a day care home requests an administrative review of any action described in paragraph (l)(2) of this section.

(i) *Uniformity.* The same procedures must apply to all day care homes.

(ii) *Representation.* The day care home may retain legal counsel, or may be represented by another person.

(iii) *Review of record and opposition.* The day care home may review the record on which the decision was based and refute the action in writing. The administrative review official is not required to hold a hearing.

(iv) *Administrative review official.* The administrative review official must be independent and impartial. This means that, although the administrative review official may be an employee of the State agency or an employee or board member of the sponsoring organization, he/she must not have been involved in the action that is the subject of the administrative review or have a direct personal or financial interest in the outcome of the administrative review;

(v) *Basis for decision.* The administrative review official must make a determination based on the information provided by the sponsoring organization and the day care home and on Federal and State laws, regulations, polices, and procedures governing the Program.

(vi) *Time for issuing a decision.* The administrative review official must inform the sponsoring organization and the day care home of the administrative review's outcome within the period of time specified in the State agency's or sponsoring organization's administrative review procedures. This timeframe is an administrative requirement for the State agency or sponsoring organization and may not be used as a basis for overturning the termination if a decision is not made within the specified timeframe.

(vii) *Final decision.* The determination made by the administrative review official is the final administrative determination to be afforded the day care home.

(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 (7 CFR Parts 15, 15a, and 15b). 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)(4) 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.* Reviews must:

(i) Assess institutional compliance with the provisions of this part and with any applicable instructions of FNS and the Department;

(ii) Evaluate the documentation used by sponsoring organizations to classify their day care homes as tier I day care homes; and

(iii) Evaluate sponsoring organizations' implementation of serious deficiency and termination procedures and, if delegated to sponsoring organizations pursuant to paragraph (l)(1) of this section, the administrative review procedures for day care homes.

(4) *Review frequency.* The State agency must annually review 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 1–100 facilities must be reviewed at least once every three years. A review of a sponsoring organization must include 10 percent of its 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 operation.

* * * * *

(p) * * * The State agency must also include in this agreement its policy to restrict transfers of day care homes between sponsoring organizations. The policy must restrict the transfers to no more frequently than once per year, except under extenuating circumstances, such as termination of the sponsoring organization's agreement or other circumstances defined by the State agency. * * *

* * * * *

4. In § 226.7, paragraph (g) is amended by adding two new sentences after the second sentence to read as follows:

§ 226.7 State agency responsibilities for financial management.

* * * * *

(g) * * * 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. * * *

* * * * *

§ 226.8 [Amended]

5. In § 226.8(g), the words ''in § 226.6(j) of this part'' are removed and the words ''in § 226.6(k)'' are added in their place.

6. In § 226.12, paragraph (b)(2)(i) is revised to read as follows:

§ 226.12 Administrative payments to sponsoring organizations for day care homes.

* * * * *

(b) * * *

(2) * * *

(i) Public status or tax exempt status under the Internal Revenue Code of 1986;

* * * * *

7. In § 226.14, paragraph (a) is amended by adding five new sentences after the second sentence to read as follows:

§ 226.14 Claims against institutions.

(a) * * * The State agency may permit institutions to pay overclaims over a period of one or more years. However, the State agency must assess interest beginning with the initial demand for remittance. Further, when an institution requests and is granted an administrative review of the State agency's overpayment demand, the State agency is prohibited from taking action to collect or offset the overpayment until the administrative review is concluded. The State agency must maintain searchable records of funds recovery activities. If the State agency determines that a sponsoring organization of centers has spent more than 15 percent of its meal reimbursements for a budget year for administrative costs (or more than any higher limit established pursuant to a waiver granted under § 226.6(f)(3)), the State agency must take appropriate fiscal action. * * *

* * * * *

8. In § 226.15:

a. Paragraph (a) is revised;

b. The heading and introductory text of paragraph (b) are revised;

c. The word ''and'' is removed at the end of paragraph (b)(5), the period at the end of paragraph (b)(6) is removed, and a semicolon is added in its place; and

b. New paragraphs (b)(7) through (b)(9) are added.

The revisions and additions specified above read as follows:

§ 226.15 Institution provisions.

(a) *Tax exempt status.* Except for proprietary title XIX and title XX centers, and sponsoring organizations of such centers, institutions must be public, or have tax exempt status under the Internal Revenue Code of 1986.

(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 the institution has the administrative and financial capability to operate the Program in accordance with this part and with the performance standards set forth at § 226.6 (b)(18). The State agency must deny the application of any institution that does not demonstrate in its application that it is administratively and financially capable of operating the Program in accordance with this part, and may approve only those applicant institutions that meet the performance standards. No institution may submit an application if the institution or any of its principals is on the National disqualified list, and no sponsoring organization may submit an application on behalf of a facility if the facility or any of its principals is on the National disqualified list. At a minimum, such information must include:

* * * * *

(7) A list of the publicly funded programs in which the institution and its principals have participated in the past seven years and a certification that, during the preceding seven years, neither the institution nor any of its principals has been declared ineligible to participate in any publicly funded program by reason of violating that program's requirements. Instead of such a certification, the institution may submit 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;

(8) A statement certifying 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; and

(9) A statement certifying 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.

* * * * *

9. In § 226.16:

a. The introductory text of paragraph (b) is amended by adding a new

sentence at the beginning of the paragraph;

b. Paragraph (b)(1) is revised;

c. Paragraph (b)(2) is amended by removing the word ''and'' at the end of the paragraph;

d. Paragraph (b)(3) is amended by removing the period at the end of the paragraph and adding in its place a semicolon;

e. New paragraphs (b)(4) through (b)(8) are added;

f. The introductory text of paragraph (d) is revised;

g. Paragraph (d)(4) is revised; and

h. A new paragraph (l) is added.

The additions and revisions specified above read as follows:

§ 226.16 Sponsoring organization provisions.

* * * * *

(b) A sponsoring organization is prohibited from submitting an application on behalf of a facility if either the facility or any of its principals is on the National disqualified list.

* * *

(1) A sponsoring organization management plan and administrative budget, in accordance with § 226.6(f)(2), which includes information sufficient to document the sponsoring organization's compliance with the performance standards set forth at § 226.6(b)(18). 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 monitoring 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 the specified ranges and the factors established by the State agency in accordance with § 226.6(f)(2). The monitoring staff equivalent may include the employee's time spent on scheduling, travel time, review time, follow-up activity, and report writing. Sponsoring organizations that are participating in the Program on July 29, 2002 must submit a management plan or plan amendment that meets the monitoring staffing requirement no later than July 29, 2003. For sponsoring organizations of centers, the portion of the administrative costs to be charged to the Program as shown on the administrative budget and the actual administrative costs 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 § 226.6(f)(3). A sponsoring organization of centers must include in its 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 waived granted under § 226.6(f)(3)) or seek a waiver. Failure to do so will result in appropriate fiscal action in accordance with § 226.14(a).

* * * * *

(4) For sponsoring organizations applying for initial participation on or after June 20, 2000, if required by State law, regulation, or policy, a bond in the form prescribed by such law, regulation, or policy;

(5) A copy of the sponsoring organization's notice to parents, in a form and, to the maximum extent practicable, language easily understandable by the participant's parents or guardians. The notice must inform them of their facility's participation in CACFP, the Program's benefits, the name and telephone number of the sponsoring organization, and the name and telephone number of the State agency responsible for administration of CACFP;

(6) If the sponsoring organization chooses to establish procedures for determining a day care home seriously deficient that supplement the procedures in paragraph (l) of this section, a copy of those supplemental procedures. If the State agency has made the sponsoring organization responsible for the administrative review of a proposed termination of a day care home's agreement for cause, pursuant to § 226.6(l)(1), a copy of the sponsoring organization's administrative review procedures. The sponsoring organization's supplemental serious deficiency and administrative review procedures must comply with paragraph (l) of this section and § 226.6(l);

(7) A copy of their 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; and

(8) For sponsoring organizations of day care homes, the name, mailing address, and date of birth of each provider.

* * * * *

(d) Each sponsoring organization must provide adequate supervisory and operational personnel for the effective management and monitoring of the program at all facilities it sponsors. Each sponsoring organization must employ monitoring staff sufficient to meet the requirements of paragraph (b)(1) of this section. At a minimum, Program assistance must include:

* * * * *

(4) Reviews of food service operations to assess compliance with meal pattern, recordkeeping, and other Program requirements.

(i) *Reviews of sponsored centers.* Reviews must be made at least three times each year at each center. 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 the center's first six weeks of Program operation; and

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

(ii) *Reviews of day care homes.* Reviews must be made at least three times each year at each day care home, except as described at paragraph (d)(4)(iii) 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 the day care home's first four weeks of Program operation; and

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

(iii) *Variation for sponsoring organizations of day care homes.* If the State agency believes that improved efficiency and more effective management will result, and subject to FNSRO approval, the State agency may allow a sponsoring organization to conduct reviews an *average* of at least three times each year per day care home, provided that:

(A) Each day care home receives at least two unannounced reviews;

(B) At least one review is made during each day care home's first four weeks of Program operations; and

(C) No more than six months elapse between reviews;

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

(v) *Notification.* Sponsoring organizations must provide each sponsored center 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 their operations during the center's normal hours of child or adult care operations, 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 July 29, 2002, the sponsoring organization must provide this notice sent 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).

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

* * * * *

(l) *Termination of agreements for cause.* (1) *General.* The sponsoring organization must initiate action to terminate the agreement of a day care home for cause if the sponsoring organization determines the day care home has committed one or more serious deficiency listed in paragraph (l)(2) of this section.

(2) *List of serious deficiencies for day care homes.* Serious deficiencies for day care homes are:

(i) Submission of false information on the application;

(ii) Submission of false claims for reimbursement;

(iii) Simultaneous participation under more than one sponsoring organization;

(iv) Non-compliance with the Program meal pattern;

(v) Failure to keep required records;

(vi) Conduct or conditions that threaten the health or safety of a child(ren) in care, or the public health or safety;

(vii) A determination that the day care home 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, or the concealment of such a conviction; or

(viii) Any other circumstance related to non-performance under the sponsoring organization-day care home agreement, as specified by the sponsoring organization or the State agency.

(3) *Serious deficiency notification procedures.* If the sponsoring organization determines that a day care home has committed one or more serious deficiency listed in paragraph (l)(2) of this section, the sponsoring organization must use the following procedures to provide the day care home notice of the serious deficiency(ies) and offer it an opportunity to take corrective action. However, if the serious deficiency(ies) constitutes an imminent threat to the health or safety of participants, or the day care home has engaged in activities that threaten the public health or safety, the sponsoring organization must follow the procedures in paragraph (l)(4) of this section instead of those in this paragraph (l)(3).

(i) *Notice of serious deficiency.* The sponsoring organization must notify the day care home that it has been found to be seriously deficient. The sponsoring organization must provide a copy of the serious deficiency notice to the State agency. The notice must specify:

(A) The serious deficiency(ies);

(B) The actions to be taken by the day care home to correct the serious deficiency(ies);

(C) The time allotted to correct the serious deficiency(ies) (as soon as possible, but not to exceed 30 days);

(D) That the serious deficiency determination is not subject to administrative review.

(E) That failure to fully and permanently correct the serious deficiency(ies) within the allotted time will result in the institution's proposed termination of the day care home's agreement and the proposed disqualification of the day care home and its principals; and

(F) That the day care home's voluntary termination of its agreement with the institution after having been notified that it is seriously deficient will still result in the day care home's formal termination by the State institution and placement of the day care home and its principals on the National disqualified list.

(ii) *Successful corrective action.* If the day care home corrects the serious deficiency(ies) within the allotted time and to the sponsoring organization's satisfaction, the sponsoring organization must notify the day care home that it has rescinded its determination of serious deficiency. The sponsoring organization must also provide a copy of the notice to the State agency.

(iii) *Proposed termination of agreement and proposed disqualification.* If timely corrective action is not taken to fully and permanently correct the serious deficiency(ies) cited, the sponsoring organization must issue a notice proposing to terminate the day care home's agreement for cause. The notice must explain the day care home's opportunity for an administrative review of the proposed termination in accordance with § 226.6(l). The sponsoring organization must provide a copy of the notice to the State agency. The notice must:

(A) Inform the day care home that it may continue to participate and receive Program reimbursement for eligible meals served until its administrative review is concluded;

(B) Inform the day care home that termination of the day care home's agreement will result in the day care home's termination for cause and disqualification; and

(C) State that if the day care home seeks to voluntarily terminate its agreement after receiving the notice of intent to terminate, the day care home will still be placed on the National disqualified list.

(iv) *Program payments.* The sponsoring organization must continue to pay any claims for reimbursement for eligible meals served until the serious deficiency(ies) is corrected or the day care home's agreement is terminated, including the period of any administrative review.

(v) *Agreement termination and disqualification.* The sponsoring organization must immediately terminate the day care home's agreement and disqualify the day care home when the administrative review official upholds the sponsoring organization's proposed termination and proposed disqualification, or when the day care home's opportunity to request an administrative review expires. At the same time the notice is issued, the sponsoring organization must provide a

copy of the termination and disqualification letter to the State agency.

(4) *Suspension of participation for day care homes.*

(i) *General.* If State or local health or licensing officials have cited a day care home for serious health or safety violations, the sponsoring organization must immediately suspend the home's CACFP participation prior to any formal action to revoke the home's licensure or approval. If the sponsoring organization determines that there is an imminent threat to the health or safety of participants at a day care home, or that the day care home has engaged in activities that threaten the public health or safety, and the licensing agency cannot make an immediate onsite visit, the sponsoring organization must immediately notify the appropriate State or local licensing and health authorities and take action that is consistent with the recommendations and requirements of those authorities. An imminent threat to the health or safety of participants and engaging in activities that threaten the public health or safety constitute serious deficiencies; however, the sponsoring organization must use the procedures in this paragraph (l)(4) (and not the procedures in paragraph (l)(3) of this section) to provide the day care home notice of the suspension of participation, serious deficiency, and proposed termination of the day care home's agreement.

(ii) *Notice of suspension, serious deficiency, and proposed termination.* The sponsoring organization must notify the day care home that its participation has been suspended, that the day care home has been determined seriously deficient, and that the sponsoring organization proposes to terminate the day care home's agreement for cause, and must provide a copy of the notice to the State agency. The notice must:

(A) Specify the serious deficiency(ies) found and the day care home's opportunity for an administrative review of the proposed termination in accordance with § 226.6(l);

(B) State that participation (including all Program payments) will remain suspended until the administrative review is concluded;

(C) Inform the day care home that if the administrative review official overturns the suspension, the day care home may claim reimbursement for eligible meals served during the suspension;

(D) Inform the day care home that termination of the day care home's agreement will result in the placement of the day care home on the National disqualified list; and

(E) State that if the day care home seeks to voluntarily terminate its agreement after receiving the notice of proposed termination, the day care home will still be terminated for cause and disqualified.

(iii) *Agreement termination and disqualification.* The sponsoring organization must immediately terminate the day care home's agreement and disqualify the day care home when the administrative review official upholds the sponsoring organization's proposed termination, or when the day care home's opportunity to request an administrative review expires.

(iv) *Program payments.* A sponsoring organization is prohibited from making any Program payments to a day care home that has been suspended until any administrative review of the proposed termination is completed. If the suspended day care home prevails in the administrative review of the proposed termination, the sponsoring organization must reimburse the day care home for eligible meals served during the suspension period.

10. In § 226.17:

a. Paragraph (b)(2) is amended by removing the comma and all text that follows the words ''the Internal Revenue Code of 1986'' and adding a period in its place; and

b. A new paragraph (d) is added.

The addition above reads as follows:

§ 226.17 Child care center provisions.

* * * * *

(d) If so instructed by its sponsoring organization, a sponsored center must distribute to parents a copy of the sponsoring organization's notice to parents.

11. In § 226.18:

a. A new sentence is added to the introductory text of paragraph (b) after the third sentence;

b. Paragraph (b)(1) is revised;

c. Remove the word ''and'' at the end of paragraph (b)(8);

d. Remove the period at the end of paragraphs (b)(9), (b)(10), (b)(11), and (b)(12) and add a semicolon in its place; and

e. New paragraphs (b)(13), (b)(14), (b)(15), and (b)(16) are added.

The revision and additions specified above read as follows:

§ 226.18 Day care home provisions.

* * * * *

(b) * * * The agreement must be signed by the sponsoring organization and the provider and must include the provider's full name, mailing address, and date of birth. * * *

(1) The right of the sponsoring organization, the State agency, the Department, and other State and Federal officials to make announced or unannounced reviews of the day care home's operations and to have access to its meal service and records during its normal hours of child care operations. For day care homes participating July 29, 2002, the sponsoring organization must amend the current agreement no later than August 29, 2002;

* * * * *

(13) The State agency's policy to restrict transfers of day care homes between sponsoring organizations;

(14) The responsibility of the day care home to notify their sponsoring organization in advance whenever they are planning to be out of their home during the meal service period. The agreement must also state that, if this procedure is not followed and an unannounced review is conducted when the children are not present in the day care home, claims for meals that would have been served during the unannounced review will be disallowed;

(15) The day care home's opportunity to request an administrative review if a sponsoring organization issues a notice of proposed termination of the day care home's Program agreement, or if a sponsoring organization suspends participation due to health and safety concerns, in accordance with § 226.6(1)(2); and

(16) If so instructed by its sponsoring organization, the day care home's responsibility to distribute to parents a copy of the sponsoring organization's notice to parents.

* * * * *

§ 226.19 [Amended]

12. In § 226.19, paragraph (b)(2) is amended by removing the comma and all text that follows the words ''the Internal Revenue Code of 1986'' and adding a period in its place.

§ 226.19a [Amended]

13. In § 226.19a, paragraph (b)(4) is amended by removing the comma and all text that follows the words ''the Internal Revenue Code of 1986'' and adding a period in its place.

§ 226.23 [Amended]

14. In § 226.23:

a. The introductory text of paragraph (h) is amended by removing the word ''four'' in the second sentence and adding in its place the word ''three'', and by removing the reference ''226.6(l)'' and adding the reference ''226.6(m)'' in their place.

b. Paragraph (h)(1) is amended by removing the words ''section 226.6(l) of this Part'' in the second sentence and

adding the words ''§ 226.6(m)'' in their place.

Dated: June 7, 2002.

Eric M. Bost,

Under Secretary for Food, Nutrition, and Consumer Services.

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