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

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

(4) A State may count the reductions attributable to enforcement mechanisms or procedural requirements that are used to enforce existing eligibility criteria (e.g., fingerprinting or other verification techniques) to the extent that such mechanisms or requirements identify or deter families otherwise ineligible under existing rules.

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

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

(a) The caseload reduction credit is based on decreases in caseloads receiving TANF- or SSP-MOE-funded assistance (other than those excluded pursuant to § 261.42).

(b)(1) A State that is investing State MOE funds in excess of the required 80 percent or 75 percent basic MOE amount need only include the pro rata share of caseloads receiving assistance that is required to meet basic MOE requirements.

(2) For purposes of paragraph (b)(1) of this section, a State may exclude from the overall caseload reduction credit calculation the number of cases funded with excess MOE. This number is calculated by dividing annual excess MOE expenditures on assistance by the average monthly expenditures on assistance per case for the fiscal year,

(i) Where annual excess MOE expenditures on assistance equal total annual MOE expenditures minus the percentage of historic State expenditures specified in paragraph (v) of this section, multiplied by the percentage that annual expenditures on assistance (both Federal and State) represent of all annual expenditures, and

(ii) Where the average monthly assistance expenditures per case for the fiscal year equal the sum of annual TANF and SSP–MOE assistance expenditures (both Federal and State) divided by the average monthly sum of TANF and SSP–MOE caseloads for the fiscal year.

(iii) If the excess MOE calculation is for a separate two-parent caseload reduction credit, we multiply the number of cases funded with excess MOE by the average monthly percentage of two-parent cases in the State's total (TANF plus SSP–MOE) average monthly caseload.

(iv) All financial data must agree with data reported on the TANF Financial Report (form ACF–196) and all caseload data must agree with data reported on the TANF Data and SSP–MOE Data Reports (forms ACF–199 and ACF–209).

(v) The State must use 80 percent of historic expenditures when calculating excess MOE; however if it has met the work participation requirements for the year, it may use 75 percent of historic expenditures.

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

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

Subpart E—What Penalties Apply to States Related to Work Requirements?

§ 261.50 What happens if a State fails to meet the participation rates?

(a) If we determine that a State did not achieve one of the required minimum work participation rates, we must reduce the SFAG payable to the State.

(b)(1) If there was no penalty for the preceding fiscal year, the base penalty for the current fiscal year is five percent of the adjusted SFAG.

(2) For each consecutive year that the State is subject to a penalty under this part, we will increase the amount of the base penalty by two percentage points over the previous year's penalty. However, the penalty can never exceed 21 percent of the State's adjusted SFAG.

(c) We impose a penalty by reducing the SFAG payable for the fiscal year that immediately follows our final determination that a State is subject to a penalty and our final determination of the penalty amount.

(d) In accordance with the procedures specified at § 262.4 of this chapter, a State may dispute our determination that it is subject to a penalty.

§ 261.51 Under what circumstances will we reduce the amount of the penalty below the maximum?

(a) We will reduce the amount of the penalty based on the degree of the State's noncompliance.

(1) If the State fails only the two-parent participation rate specified at § 261.23, reduced by any applicable caseload reduction credit, its maximum penalty will be a percentage of the penalty specified at § 261.50. This percentage will equal the percentage of two-parent cases in the State's total caseload.

(2) If the State fails the overall participation rate specified at § 261.21, reduced by any applicable caseload reduction credit, or both rates, its maximum penalty will be the penalty specified at § 261.50.

(b)(1) In order to receive a reduction of the penalty amounts determined under paragraphs (a)(1) or (a)(2) of this section:

(i) The State must achieve participation rates equal to a threshold level defined as 50 percent of the applicable minimum participation rate at § 261.21 or § 261.23, minus any caseload reduction credit determined pursuant to subpart D of this part; and

(ii) The adjustment factor for changes in the number of individuals engaged in work, described in paragraph (b)(4) of this section, must be greater than zero.

(2) If the State meets the requirements of paragraph (b)(1) of this section, we will base its reduction on the severity of the failure. For this purpose, we will calculate the severity of the State's failure based on:

(i) The degree to which it missed the target rate;

(ii) An adjustment factor that accounts for changes in the number of individuals who are engaged in work in the State since the prior year; and

(iii) The number of consecutive years in which the State failed to meet the participation rates and the number of rates missed.

(3) We will determine the degree to which the State missed the target rate using the ratio of the following two factors:

(i) The difference between the participation rate achieved by the State and the 50-percent threshold level (adjusted for any caseload reduction credit determined pursuant to subpart D of this part); and

(ii) The difference between the minimum applicable participation rate and the threshold level (both adjusted for any caseload reduction credit determined pursuant to subpart D of this part).

(4) We will calculate the adjustment factor for changes in the number of individuals engaged in work using the following formula:

(i) The average monthly number of individuals engaged in work in the penalty year minus the average monthly number of individuals engaged in work in the prior year, divided by,

(ii) The product of 0.15 and the average monthly number of individuals engaged in work in the prior year.

(5) Subject to paragraph (c) of this section, if the State fails only the two-parent participation rate specified at § 261.23, and qualifies for a penalty reduction under paragraph (b)(1) of this section, its penalty reduction will be the product of:

(i) The amount determined in paragraph (a)(1) of this section;

(ii) The ratio described in paragraph (b)(3) of this section computed with respect to two-parent families; and

(iii) The adjustment factor described in paragraph (b)(4) of this section computed with respect to two-parent families.

(6) Subject to paragraph (c) of this section, if the State fails the overall