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Part V

Department of Health and Human Services

Administration for Children and Families

**45 CFR Parts 302, 304, and 305
Child Support Enforcement Program;
Final Rule**

DEPARTMENT OF HEALTH AND HUMAN SERVICES**Administration for Children and Families****45 CFR Parts 302, 304 and 305**

RIN 0970-AB85

Child Support Enforcement Program; Incentive Payments, Audit Penalties**AGENCY:** Office of Child Support Enforcement (OCSE), HHS.**ACTION:** Final rule.

SUMMARY: This final rule implements the statutory requirement of the Social Security Act that requires the Secretary of Health and Human Services to establish the new performance-based incentive system. It also implements a performance-based penalty system and establishes standards for certain types of audits. Finally, this rule includes a requirement that States establish an administrative review process. The incentive system will be used to reward States for their performance in running a Child Support Enforcement (IV-D) Program. The penalty system will be used to penalize States that fail to perform at acceptable levels or fail to submit complete and reliable data.

EFFECTIVE DATE: The final rule is effective: December 27, 2000. Section 304.12 is effective through September 30, 2001.

FOR FURTHER INFORMATION CONTACT: Joyce Pitts, OCSE Division of Policy and Planning, (202) 401-5374. Hearing impaired individuals may call the Federal Dual Party Relay Service at 800-877-8339 between 8:00 a.m. and 7:00 p.m. eastern time.

SUPPLEMENTARY INFORMATION:**I. Statutory and Regulatory Authority**

These regulations implement sections 409(a)(8), 452(a)(4) and (g), and 458A of the Social Security Act (Act), as added by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. 104-193, (PRWORA), by the Child Support Performance and Incentive Act of 1998, Pub. L. 105-200, and as amended by the Balanced Budget Act of 1997, Pub. L. 105-33 and the Consolidated Appropriations Act of FY 2000, Pub. L. 106-113.

These regulations are also issued under the authority granted to the Secretary of Health and Human Services (the Secretary) by section 1102 of the Act, 42 U.S.C. 1302. Section 1102 of the Act authorizes the Secretary to publish regulations that may be necessary for the efficient administration of the

functions for which the Secretary is responsible under the Act.

II. Background*A. The National Strategic Plan*

The Government Performance and Results Act of 1993 required Federal programs to set goals and measure results by establishing strategic plans. OCSE and State partners developed a National Child Support Enforcement Strategic Plan by consensus with a vision, mission, goals and objectives. The plan includes three major goals for the child support program—that all children have paternity established, all children in the program have financial and medical support orders established, and all children in the program receive financial and medical support from both parents.

After development of the National Child Support Enforcement Strategic Plan, States and OCSE worked together to develop specific performance indicators that could be used to measure the program's success in achieving the goals and objectives. It was this Strategic Plan and its performance measures that the States and OCSE used to recommend a performance-based incentive funding system to reward States for results. The Plan's array of performance measures was reviewed and the key indicators for the major activities of the child support enforcement program were selected. The Strategic Plan measures and the incentive measures for paternity establishment, support order establishment, collections on current support and cost-effectiveness are the same. The only deviation from the plan was the measure for collections on past-due support. State and Federal partners rejected the Strategic Plan measure that would provide an arrearage collection rate because there is a wide variation in how States' laws affect arrearages. State and Federal partners concluded that the only workable measure that would level the playing field among States in this important area was one based on the number of cases that were paying on arrears.

After the incentive funding proposals were developed, State and Federal partners further collaborated to recommend a system of performance penalties for States. They returned to the Strategic Plan and the recommended incentive funding system that was being considered for legislation. The partners focused on those key measures of the program's performance which had been recommended for incentives and chose a subset of the incentive measures for application of financial penalties. These

were the incentive measures which were given a greater weight in the computation of the incentive formula—paternity establishment, order establishment and the collection of current support.

The Strategic Plan was also the basis for shaping a revision of the child support data reporting and collection systems and the role of the Federal audit process. This implements key structures that have been shaped and guided by the Strategic Plan and these structures will, in turn, help achieve outcomes that fulfill the goals and objectives of the Plan itself.

B. Issues and Activities Leading to the New Incentive Provisions

Under section 458 of title IV-D of the Act, States are paid a minimum of six percent of their collections in TANF cases and six percent of their non-TANF collections as an incentive. Under this system, there is also the potential to earn up to 10 percent of collections based on the State's cost-effectiveness in running a child support program. However, the amount of non-TANF incentives is capped at 115 percent of the TANF incentive earned.

This incentive system has been questioned for focusing on only one aspect of the IV-D program—Cost-effectiveness. In addition, since all States receive the minimum incentive amount of six percent of collections regardless of performance, this system was not regarded as having a real incentive effect.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) required the Secretary, in consultation with State IV-D Program Directors, to recommend to Congress a new incentive funding system for State IV-D programs based on program performance. The Incentive Funding Workgroup recommended a new incentive funding system based on the foundation of the National Strategic Plan.

The Secretary fully endorsed the incentive formula recommendations and made recommendations to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate. Most of the recommendations were included in Pub. L. 105-200, the Child Support Performance and Incentive Act of 1998. This rule implements that legislation. The legislative language is very explicit. Therefore, we are for the most part adopting the statutory language in this rule.

C. Audit and Penalties

Prior to enactment of PRWORA, the Federal statute at former section 452(a)(4) of the Act required periodic, comprehensive Federal audits of State IV-D programs to ensure substantial compliance with all Federal IV-D requirements. If the audit found that the State program was not in substantial compliance and if the deficiencies identified in an audit were not corrected, States faced a mandatory fiscal penalty of between 1 and 5 percent of the Federal share of the State's title IV-A program funding under section 403(h) of the Act. Once an audit determined compliance with identified deficiencies, the penalty was lifted or ceased.

Such a detailed, process-oriented audit was time-consuming and labor-intensive for both Federal auditors and the States. In addition, audit findings did not measure current State performance or current program requirements because of delays and the time it took to conduct audits. States contended that the audits focused too much on administrative procedures and processes rather than performance outcome and results.

Section 452(a)(4) of the Act, as amended by PRWORA, changed the Federal audit process to focus on measuring performance and program results, instead of process. Subsequently, as part of technical amendments to PRWORA, the penalty provision under section 409(a)(8) of the Act was modified to conform to the new audit approach under the IV-D program. The new approach to measuring program results changes the Federal audit focus to determining the reliability of program data used to measure performance and requires States to conduct self-reviews, similar to the former Federal process audits, to assess whether or not all required IV-D services are being provided. In addition, Federal auditors will conduct periodic financial and other audits, as necessary.

The penalty system in this rule replaces the previous penalty under former section 403(h) of the Act that focused on substantial compliance with prescriptive Federal IV-D requirements. However, section 452(a)(4)(C)(iii) provides for audits for such other purposes as the Secretary may find necessary and section 409(a)(8) provides for a penalty "on the basis of the results of an audit. * * *

The assessment of data reliability by Federal auditors is a critical aspect of assuring that both incentives and penalties are based on accurate and reliable State-reported data. State-

reported statistical and financial data taken from reporting forms, the OCSE-157, the OCSE-34A, and the OCSE-396A, will be audited for completeness and reliability and will be used in determining State performance levels. State-reported data that is determined to be incomplete or unreliable may cause reductions in the State's funding under the IV-A (Temporary Assistance for Needy Families) program and will result in loss of Federal incentive payments under the IV-D program.

While the specifics of performance measures for penalty purposes, with the exception of the Paternity Establishment Percentage (PEP) under section 452(g) of the Act, are left to the discretion of the Secretary, the approach to assessing penalties in this regulation takes into consideration the results of work done by State and Federal partners during the development of the National Strategic Plan and the proposal for incentive measures, as well as consultations with a wide variety of other interested parties.

III. Description of Regulatory Provisions—Incentives and Administrative Review

This final rule does not have many changes from the notice of proposed rule making published in the **Federal Register** on October 8, 1999 (64 FR 55073). However, we considered each comment and made some changes. The administrative complaint procedure was revised and clarified; a standard was added to the definition of data reliability; a deadline was established for having final incentive data to OCSE; and the incentive and reinvestment base-year calculation examples were removed.

Parts 302, 303 and 304—State Plan Requirements, Standards for Program Operations, and Federal Financial Participation

The cross-references to existing regulations mentioned in this Description of Regulatory Provisions are as amended by the Interim Final Conforming Rule (64 FR 6237) published in the **Federal Register** February 9, 1999.

Sections 302.55 and 304.12—Regulations for Existing Incentives Process.

Currently, under section 454(22) of the Act and 45 CFR 302.55, the only restriction on the use of incentive funds awarded to the State is that States must share incentives earned with any political subdivision that shares in funding the administrative cost of the program. The requirement to share

funds with political subdivisions is not being changed. Therefore, we are adding reference to the new part 305 in § 302.55 by adding the words "and part 305" after "§ 304.12".

Current 45 CFR 304.12(b)(1), as revised on February 9, 1999 at 64 FR 6237, based on section 458 of the Act, computes incentive payments for States for a fiscal year as a percentage of the State's TANF collections, and a percentage of its non-TANF collections. The percentages are determined separately for TANF and non-TANF portions of the incentive. The percentages are based on the ratio of the State's TANF collections to the State's total administrative costs and the State's non-TANF collections to the State's total administrative costs. This is known as a State's cost-effectiveness ratio. The portion of the incentive payment paid to a State in recognition of its non-TANF collections is limited to 115 percent of the portion of the incentive payment paid in recognition of its TANF collections.

HHS estimates the total incentive payment that each State will receive for the upcoming fiscal year. Each State includes one-quarter of the estimated total payment in its quarterly collection report that will reduce the amount that would otherwise be paid to the Federal government. Following the end of the fiscal year, HHS calculates the actual incentive payment the State should have received. If adjustments to the estimated amount are necessary, an additional positive or negative title IV-D grant award is issued.

Under section 201(f) of the Child Support Performance and Incentive Act of 1998, effective October 1, 2001, current section 458 of the Act will be repealed and section 458A of the Act, will be redesignated as section 458. To implement this statutory provision, we added a new paragraph (d) to § 304.12 under which § 304.12 in its entirety becomes obsolete on October 1, 2001.

A new paragraph (e) is also added to reflect the phase-in of the new incentive system as prescribed under section 201(b) of the Child Support Performance and Incentive Act. In fiscal year 2000, the amount of incentives paid under § 304.12 will be reduced by one-third. In fiscal year 2001, the amount of incentives paid under § 304.12 will be reduced by two-thirds.

Section 303.35—Administrative complaint procedure

We have shifted to using an outcome-oriented approach to child support enforcement program accountability and responsibility. This approach, much of which was adopted under PRWORA,

seeks to balance the Federal government's oversight responsibility with States' responsibilities for child support service delivery and fiscal accountability. One element of the approach, adopted partially in PRWORA and being implemented by these final regulations, is the focus on results-oriented performance measures for incentives and penalties purposes. A second aspect of the approach replaces statutory and regulatory Federal audit requirements with States' responsibility for ensuring that their programs meet IV-D requirements. The requirement for periodic State self-reviews, intended for management purposes to identify and resolve deficiencies in case processing, was also adopted under PRWORA as a State plan requirement at section 454(15)(A) of the Act. Procedures for State self-reviews are being implemented under a separate rulemaking.

Although Federal funding of administrative review processes has long been considered an allowable expenditure under the IV-D program, we believe it to be a key element to any IV-D program. In the era of our focus on program results, we believe it appropriate to ensure that these administrative complaint processes are available to recipients of IV-D services. Using the authority under section 1102 of the Act to publish regulations that the Secretary deems necessary for the efficient administration of the IV-D program, we have added a section to part 303 requiring States to provide for an administrative review.

Under § 303.35, entitled Administrative Complaint Procedure, each State must have a procedure in place to allow individuals receiving IV-D services the opportunity to request a review of their cases when there is evidence that an action should have been taken on their cases. In addition, the State must have procedures in place, notify individuals of the procedures, and make them available to recipients of IV-D services to use when requesting a review, and use them for notifying recipients of the results of the review and any actions taken.

This final rule revises § 303.35 as it appeared in the notice of proposed rulemaking published in the **Federal Register** on October 8, 1999 (64 FR 55073). These changes were made to balance our concern for efficient IV-D service provision with our commitment to allowing States discretion and flexibility in program design. We believe that recipients of IV-D services, through administrative complaint procedures, should be able to lodge complaints when they have evidence to

support specific concerns in their cases. However, we have revised the regulatory language to address concerns that the proposed language was overly broad and open to multiple interpretations. In addition, we have included language to require States to notify individuals of the availability of administrative complaint procedures.

Part 305—Program Performance Measures, Standards, Financial Incentives, and Penalties

We added a new part 305 to implement the new incentive system under section 458A of the Act and certain audit and penalty provisions found in sections 409(a)(8), 452(a)(4)(C) and 452(g) of the Act. Former part 305 was revoked on February 9, 1999 at 64 FR 6237.

Section 305.0 Scope.

Section 305.0, Scope, explains what part 305 covers, including the statutory basis for the incentive and penalty systems and a general description of the contents of part 305. Section 305.1 contains definitions and § 305.2 contains performance measures. Sections 305.31 through § 305.36 of part 305 describe the incentive system. Sections 305.40 through § 305.42 and §§ 305.60 through § 305.66 describe the grounds for penalties under section 409(a)(8) of the Act, the procedures for imposing penalties, the types of audits, and set forth the standards for substantial compliance audits and certain audit procedures.

Section 305.1 Definitions.

Under § 305.1, Definitions, the definitions found in § 301.1 of program regulations also apply to part 305. In addition, for purposes of part 305, § 305.1 defines the following terms:

Under paragraph (a), the term IV-D case means a parent (mother, father, or putative father) who is now or eventually may be obligated under law for the support of a child or children receiving services under the title IV-D program. A parent is a separate IV-D case for each family with a dependent child or children that the parent may be obligated to support. If both parents are absent and liable or potentially liable for support of a child or children receiving services under the IV-D program, each parent is considered a separate IV-D case. In counting cases for the purposes of this part, States may exclude cases closed under § 303.11 and cases over which the State has no jurisdiction. Lack of jurisdiction cases are those in which a non-custodial parent resides in the civil jurisdictional boundaries of another country or Federally recognized

Indian Tribe and no income or assets of this individual are located or derived from outside that jurisdiction, and the State has no other means through which to enforce the order.

The definition of a IV-D case in § 305.1 implements the requirement in section 458A(e) that the Secretary include in regulations directions for excluding from the incentive calculations certain closed cases and cases over which the States do not have jurisdiction.

The definition itself is used in required Federal report forms and defines which cases may be excluded for purposes of calculating incentives, namely, IV-D cases meeting the conditions for case closure under § 303.11 and cases over which the State has no jurisdiction. This definition assures that workable cases are counted while those cases in which there is no possible action by the IV-D agency will be discounted. It is essential that we use consistent definitions for all data and therefore, the definitions in § 305.1 apply equally for incentives and penalties purposes.

Under paragraph (b), the term *Current Assistance collections* means collections received and distributed on behalf of individuals whose rights to support are required to be assigned to the State under title IV-A (TANF or Aid to Families with Dependent Children, AFDC), IV-E (Foster Care), or XIX (Medicaid) of the Act. In addition, a referral to the State's IV-D agency must have been made. Current Assistance collections do not include collections received and distributed under the Tribal TANF program because the statute includes only those collections where there is an assignment to the State. Tribal TANF recipients are not required by statute to assign their support rights. Thus, it is inappropriate to include collections relative to Tribal TANF programs in this definition.

Under paragraph (c), the term *Former Assistance collections* means collections received and distributed on behalf of individuals whose rights to support were formerly required to be assigned to the State under either title IV-A, title IV-E, or title XIX of the Act.

Under paragraph (d), the term *Never Assistance/Other collections* means all other collections received and distributed on behalf of individuals who are receiving child support enforcement services under title IV-D of the Act.

The definitions of various categories of collections above reflect categories of collections described in section 458A(b)(5)(C) of the Act and used to calculate the State's collections base used for computing incentives. Current

Assistance and Former Assistance collections are multiplied by 2 and added to Never Assistance/Other collections to determine the State's collections base.

Under paragraph (e), the term *total IV-D dollars expended* means total IV-D administrative expenditures claimed by a State in a specified fiscal year adjusted in accordance with § 305.32. Section 305.32, addressed later, includes specific expenditures that are excluded when calculating a State's total IV-D administrative expenditures for calculation of the cost-effectiveness performance measure.

The term *Consumer Price Index or CPI* in paragraph (f) is taken from the definition in section 458A(b)(2)(B) of the Act, and means the last Consumer Price Index for all-urban consumers published by the Department of Labor. The CPI for a fiscal year is the average of the Consumer Price Index for the 12-month period ending on September 30 of the fiscal year.

Under paragraph (g), the term *State incentive payment share* for a fiscal year means the incentive base amount for the State for the fiscal year divided by the sum of the incentive base amounts for all of the States for the fiscal year. This definition is found in section 458A(b)(3) of the Act.

Under paragraph (h), the term *State incentive base amount* for a fiscal year means the sum of the State's performance level percentages (determined in accordance with § 305.33) multiplied by the State's corresponding maximum incentive base amount for each of the following measures: (1) The paternity establishment performance level; (2) the support order performance level; (3) the current collections performance level; (4) the arrears collection performance level; and (5) the cost-effectiveness performance level. This definition is found in section 458A(b)(4) of the Act.

Under paragraph (i), the term *reliable data* means the most recent data available which are found by the Secretary to be reliable for purposes of computing the paternity establishment percentage. This definition is based on section 452(g)(2)(C) of the Act and includes further elaboration of the circumstances under which the Secretary will consider data to be reliable. In the final rule, we have added that data for computing each of the measures must be found to be sufficiently complete and error free to be convincing for their purpose and context. For purposes of incentives and

penalties, data must meet a 95 percent standard of reliability beginning in fiscal year 2001. The 95 percent rate was selected based on generally accepted accounting principles used by the auditing community and our experience from data reliability audits conducted to date on State systems. This standard is consistent with the recognition that "data may contain errors as long as they are not of a magnitude that would cause a reasonable person, aware of the errors, to doubt a finding or conclusion made based on the data." Part of this definition is lifted verbatim from Chapter 1, Introduction of the U.S. General Accounting Office, Office of Policy Booklet (Standards) entitled, *Assessing the Reliability of Computer-Processed Data*, dated September 1990. The official designation of this booklet is GAO/OP-8.1.3. The Government Auditing Standards—generally referred to as the "Yellow Book"—provide the standards and requirements for financial and performance audits. A key standard covers the steps to be taken when relying on computer-based evidence. This booklet from the GAO, Office of Policy is intended to help auditors meet the Yellow Book standard for ensuring that computer-based data are reliable.

Under paragraph (j), the term *complete* means all reporting elements from OCSE reporting forms that are necessary to compute a State's performance levels, incentive base amount, and maximum incentive base amount have been provided within the timeframes established in instructions to these reporting forms and § 305.32(f).

We believe the definitions in (i) and (j) are appropriate for purposes of Part 305 since State IV-D programs are required to have comprehensive statewide automated systems in place by October 1, 2000 which, under section 454A(c) of the Act, must enable the Secretary to determine the incentive payments and penalty adjustments required by sections 452(g) and 458 of the Act. In addition, under section 454(15)(A), States must have a process of extracting from the automated data processing system and transmitting to the Secretary, data and calculations concerning the levels of accomplishment and rates of improvement with respect to the applicable performance indicators for purposes of sections 452(g) and 458 of the Act. Finally, Federal auditors are required under section 452(a)(4)(C)(i) of the Act to conduct audits to assess the completeness, reliability, and security of the data, and the accuracy of the

reporting systems used in calculating performance indicators. These provisions, taken together, require a clear, accepted and supportable definition of reliable data.

Section 305.2 Performance measures

This section describes the performance measures that will be used in the incentive and penalty systems. Paragraph (a) of § 305.2, Performance measures, indicates the child support incentive system will measure State performance levels in five areas: (1) Paternity establishment; (2) child support order establishment (cases with orders); (3) collections on current support; (4) collections on arrears; and (5) cost-effectiveness. It also requires that the penalty system measure State performance in three of these areas: (1) Paternity establishment; (2) child support order establishment; and (3) collections on current support.

Paragraph (a)(1), *Paternity Establishment Performance Level*, reflects the explicit statutory language in section 458A(b)(6)(A)(i) of the Act, which gives States the choice of being evaluated on one of two measures—the IV-D or the statewide paternity establishment percentage (commonly known as the PEP), discussed in detail later. The statute and the paragraph provide that the count of children shall not include any child who is a dependent by reason of the death of a parent (unless paternity is established for that child). It also shall not include any child with respect to whom there is a finding of good cause for refusing to cooperate with the State agency in establishing paternity, or for whom the appropriate State agency determines it is against the best interest of the child to pursue paternity issues.

The IV-D paternity establishment percentage and statewide paternity establishment percentage definitions that follow are contained in paragraphs (a)(1)(i) and (ii) and are set forth in sections 452(g)(2)(A) and (B) of the Act:

IV-D Paternity Establishment Percentage means the ratio that the total number of children in the IV-D caseload in the fiscal year (or, at the option of the State, as of the end of the fiscal year) who have been born out-of-wedlock and for whom paternity has been established or acknowledged, bears to the total number of children in the IV-D caseload as of the end of the preceding fiscal year who were born out-of-wedlock. The equation to compute the measure is as follows (expressed as a percent):

Total # of Children in IV - D Caseload in the Fiscal Year or,
 at the option of the State, as of the end of the Fiscal Year who were
Born Out - of - Wedlock with Paternity Established or Acknowledged
 Total # of Children in IV - D Caseload as of the end of the preceding
 Fiscal Year who were Born Out - of - Wedlock

Statewide Paternity Establishment Percentage is the ratio that the total number of minor children who have been born out-of-wedlock and for whom paternity has been established or acknowledged during the fiscal year, bears to the total number of children born out-of-wedlock during the preceding fiscal year. The equation to compute the measure is as follows (expressed as a percent):

Total # Minor Children who have been Born Out - of - Wedlock and for
Whom Paternity has been Established or Acknowledged During the Fiscal Year
 Total # of Children Born Out of Wedlock During the Preceding Fiscal Year

The second performance measure contained in § 305.2(a)(2), Support Order Performance Level, requires a determination of whether or not there is a support order for each case. The equation to compute the measure is as follows (expressed as a percent):

Number of IV - D Cases with Child Support Orders
 Total Number of IV - D Cases

While the performance measure is defined in section 458A(b)(6)(B)(i) of the Act, paragraph (a)(2) provides guidance as to which orders are counted for calculation of performance measures. The performance measure in paragraph (a)(3) is *Current Collections Performance Level*. It measures the amount of current support collected as compared to the total amount owed. Current support is money applied to current support obligations and does not include payment plans for payment towards arrears. Voluntary collections must be included in both the numerator and the denominator. This measure will be computed monthly and the total of all months reported at the end of the year. The equation to compute the measure will be as follows (expressed as a percent):

Total Dollars Collected for Current Support in IV - D Cases
 Total Dollars Owed for Current Support in IV - D Cases

As with the other performance measures, this measure derives from section 458A(b)(6) of the Act. Finally, as provided under section 458A(c) of the Act, support collected by one State at the request of another State will be treated as having been collected in full by both States. Section 458A(b)(6)(D)(i) of the Act sets forth the arrearage collection performance level included in § 305.2(a)(4) *Arrearage Collection Performance Level*. This measure will include those cases where all of the past-due child support was disbursed to the family, or all of the past due child support was retained by the State because all the past due child support was assigned to the State. If some of the past due child support was assigned to the State and some was owed to the family, only those cases where some of the support actually was disbursed to the family will be included. The equation to compute the measure will be as follows (expressed as a percent):

Total number of eligible IV - D cases paying toward arrears
 Total number of IV - D cases with arrears due

This measure, unlike the current collections measure, counts cases with child support arrearage collections, rather than the percentage of arrearages collected. The final performance measure, reflecting section 458A(b)(6)(E)(i) of the Act, appears at paragraph (a)(5) *Cost-Effectiveness Performance Level*. This measure compares the total amount of IV-D collections for the fiscal year to the total amount of IV-D expenditures the fiscal year. The equation to compute this measure is as follows (expressed as a ratio):

Total IV - D Dollars Collected
 Total IV - D Dollars Expended

This indicator provides a basic cost-benefit analysis of a child support enforcement program. As provided under section 458A(c) of the Act, collections by one State at the request of another State will be counted as having been collected in full by both States and any amounts expended by a State in carrying out a special project under section 455(e) of the Act will be excluded. (Section 305.32 lists monies that are excluded when determining total dollars expended, such as fees collected from individuals, recovered costs and program income.)

Under § 305.2(b), as specified in section 458A(b)(5) of the Act for incentive purposes, the five performance measures will be weighted in the following manner. Each State will earn five scores based on performance on each of the five measures. The first three measures (paternity establishment, order establishment, and current collections) percentage scores earn a maximum of 100 percent of the collections base as defined in § 305.31(d). The last two measures (collections on arrears and cost-effectiveness) earn a maximum of 75 percent of the collections base as defined in § 305.31(d).

The weighting provision was recommended by State and Federal partners and included in the Secretary's report to Congress as an essential aspect of the incentive system, placing extra emphasis on getting support to families each and every month.

Section 305.31 Amount of incentive payment.

Under paragraph (a) of § 305.31 (which addresses the contents of section 458A(b) of the Act), the incentive payment for a State for a fiscal year is equal to the incentive payment pool for the fiscal year, multiplied by the State incentive payment share for the fiscal year. As specified in section 458A(b)(2) of the Act, paragraph (b) defines the incentive payment pool as:

- (1) \$422,000,000 for fiscal year 2000;
- (2) \$429,000,000 for fiscal year 2001;
- (3) \$450,000,000 for fiscal year 2002;
- (4) \$461,000,000 for fiscal year 2003;
- (5) \$454,000,000 for fiscal year 2004;
- (6) \$446,000,000 for fiscal year 2005;
- (7) \$458,000,000 for fiscal year 2006;
- (8) \$471,000,000 for fiscal year 2007;
- (9) \$483,000,000 for fiscal year 2008;

and

(10) For any succeeding fiscal year, the amount of the incentive payment pool for the fiscal year that precedes such succeeding fiscal year multiplied by the percentage (if any) by which the CPI for such preceding fiscal year exceeds the CPI for the second

preceding fiscal year. In other words, for each fiscal year following fiscal year 2008, the incentive payment pool will be multiplied by the percentage increase in the CPI between the two preceding years. For example, for fiscal year 2009, if the CPI increases by 1 percent between fiscal years 2007 and 2008, then the incentive pool for fiscal year 2009 will be a 1 percent increase over the \$483,000,000 incentive payment pool for fiscal year 2008, or \$487,830,000.

Paragraph (c) defines, in accordance with section 458A(b)(3) of the Act, the State incentive payment share for a fiscal year to be the incentive base amount for the State for the fiscal year divided by the sum of the incentive base amounts for all of the States for the fiscal year.

Under paragraph (d), a State's maximum incentive base amount for a fiscal year is the combined sum of: the State's collections base for the fiscal year for each of the paternity establishment, support order, and current collections performance measures; and 75 percent of the State's collections base for the fiscal year for the arrearage payment and cost-effectiveness performance measures. This is specified in section 458A(b)(5) of the Act.

Under paragraph (e), a State's maximum incentive base amount for a fiscal year is zero, unless a Federal audit performed under § 305.60 (described later in this preamble) determines that the data which the State submitted for the fiscal year and which will be used to determine the performance levels involved are complete and reliable. This provision is required by section 458A(b)(5)(B) of the Act. It is essential to ensure the integrity of the incentive system and the timeliness of the determinations. States are accountable for providing reliable data on a timely basis or they receive no incentives. This determination will be made using data submitted no later than the end of the first quarter of the next fiscal year (i.e. December 31). This deadline is needed so each State's data can be audited promptly during the first part of the following year to determine reliability and completeness. Allowing updates, corrections, and adjustments during that period would impede our ability to make final incentive determinations, and would result in continuing adjustment of the amount of the incentives payable to all States.

Finally, under paragraph (f), a State's collections base for a fiscal year, as provided in section 458A(b)(5)(C) of the Act, is equal to: 2 times the sum of the total amount of support collected for

Current Assistance cases plus two times the total amount of support collected in Former Assistance cases, plus the total amount of support collected in all other cases during the fiscal year, that is:

$$2 (\text{Current Assistance collections} + \text{Former Assistance collections}) + \text{all other collections.}$$

This double-weighting of collections in Current Assistance and Former Assistance cases when calculating the collection base is another key component of the new incentives system. As with the emphasis placed on the current collections performance measure to ensure consistent and timely support to families, the calculation of the State's collection base also emphasizes the goal of helping families become and remain self-sufficient.

Under the current incentive system, States lose incentives when families leave the State assistance rolls because collections in non-assistance cases are capped at 115 percent of collections in assistance cases. However, under section 458A of the Act and these regulations, collections in Former Assistance cases, as well as collections in Current Assistance cases will count double, while collections in all other cases (often seen as requiring less work by IV-D programs) will only be counted once. We note that Current Assistance cases do not include cases in which assistance is paid under a Tribal TANF program because the statutory language covers only cases where an assignment to the State is required by the Act. Tribal TANF cases have no such required assignment to the State. Tribal TANF cases will be included in Former Assistance cases to the extent that the individuals formerly were required to assign support rights to the State.

Section 305.32 Requirements applicable to calculations

Section 305.32 establishes certain special provisions applicable to calculating the amount of incentives and penalties. Some are derived from current incentive rules and practice and some are based on explicit rules in section 458A of the Act. They are also applied to penalty calculations because we are using the same measures. Under this section the following conditions apply:

Section 305.32(a) specifies that each measure will be based on data relating to the Federal fiscal year (FY). The Federal fiscal year runs from October 1st of one year through September 30th of the following year. This is consistent with current practice and reference to the fiscal year in section 458A of the Act.

Section 302.32(b) specifies that only collections disbursed or retained, as applicable, and only those expenditures made by the State, in the fiscal year will be used to determine the incentive payment payable for that fiscal year. This is consistent with the way collections have always been counted on Federal reporting forms.

Section 305.32(c) specifies that support collected by one State at the request of another State will be treated as having been collected in full by each State. Required by section 458A(c) of the Act, this maintains the same practice that exists under the current incentive system under section 458 of the Act for the new incentive system.

Section 305.32(d) specifies that amounts expended by the State in carrying out a special project under section 455(e) of the Act will be excluded from the State's total IV-D dollars expended in computing incentive payments. This implements section 458A(c) of the Act, and also appears in section 458 of the Act.

Section 305.32(e) specifies that fees paid by individuals, recovered costs, and program income, such as interest earned on collections, will be deducted from total IV-D dollars expended. This is consistent with § 304.12(b)(4)(iii) which is applicable to the current incentive system under section 458 and the requirement under § 304.50 that States exclude from quarterly expenditure claims an amount equal to all fees, interest and other income earned from services provided under the State IV-D plan.

Section 305.32(f) specifies that States are required to submit data used to determine incentives following instructions and formats required by HHS and on Office of Management and Budget (OMB) approved reporting instruments, and sets December 31st of each calendar year as the final deadline for the submittal of State data for a fiscal year. It includes any necessary data from the previous fiscal year needed to calculate the paternity establishment percentage or any improvements over that fiscal year's performance necessary to earn incentives or avoid penalties for the current fiscal year. This is consistent with the requirement in § 302.15 under which States must maintain statistical, fiscal and other records necessary for reporting and accountability required by the Secretary and make such reports in the form and containing information the Secretary requires. Data submitted as of December 31st will be used to determine the State's performance for the prior fiscal year and the amount of incentive payments due the States. We encourage States to have the capacity to

make reports (e.g., year-to-date, previous quarter) available before the end of the reporting year so that we may conduct audits to determine data reliability and completeness earlier. By doing so, States will maximize their opportunity to correct any deficiencies before the end of the reporting year or, at least, by the end of the succeeding fiscal year which the statute allows for the State to take corrective action. A cut-off point is necessary for us to make the required performance determinations and calculations on a timely basis.

Section 305.33 Determination of applicable percentages based on performance levels.

This section sets forth the explicit requirements in section 458A(b)(6) of the Act for determining the applicable percentages used to calculate incentives based on a State's performance levels in the five performance measures.

Paternity Establishment Percentage

Under paragraph (a), a State's paternity establishment performance level for a fiscal year will be, at the option of the State, the IV-D paternity establishment percentage or the Statewide paternity establishment percentage determined under § 305.2 of this part. The applicable percentage for each level of a State's paternity establishment performance is set forth in table 1, except as provided in paragraph (b).

Under paragraph (b), if the State's paternity establishment performance level for a fiscal year is less than 50 percent, but exceeds its paternity establishment performance level for the immediately preceding fiscal year by at least 10 percentage points, then the State's applicable percentage for the paternity establishment performance level is 50 percent.

Support Order

Under paragraph (c), a State's support order performance level for a fiscal year is the percentage of the total number of IV-D cases where there is a support order determined under § 305.2 and § 305.32. The applicable percentage for each level of a State's support order performance can be found on table 1, except as provided in paragraph (d).

Under paragraph (d), if the State's support order performance level for a fiscal year is less than 50 percent, but exceeds the State's support order performance level for the immediately preceding fiscal year by at least 5 percentage points, then the State's applicable percentage is 50 percent.

TABLE 1.—USE THIS TABLE TO DETERMINE THE MAXIMUM INCENTIVE LEVELS FOR THE PATERNITY ESTABLISHMENT AND SUPPORT ORDER PERFORMANCE MEASURES.

If the Paternity Establishment or Support Order Performance Level Is:

At least: (percent)	But less than: (percent)	The applicable percentage is:
80	100
79	80	98
78	79	96
77	78	94
76	77	92
75	76	90
74	75	88
73	74	86
72	73	84
71	72	82
70	71	80
69	70	79
68	69	78
67	68	77
66	67	76
65	66	75
64	65	74
63	64	73
62	63	72
61	62	71
60	61	70
59	60	69
58	59	68
57	58	67
56	57	66
55	56	65
54	55	64
53	54	63
52	53	62
51	52	61
50	51	60
0	50	0

Current Support Collections

Under paragraph (e), a State's current collections performance level for a fiscal year is equal to the total amount of current support collected during the fiscal year divided by the total amount of current support owed during the fiscal year in all IV-D cases, as determined under §§ 305.2 and 305.32. The applicable percentage with respect to a State's current collections performance level can be found on table 2, except as provided in paragraph (f).

Under paragraph (f), if the State's current collections performance level for a fiscal year is less than 40 percent but exceeds the current collections performance level of the State for the immediately preceding fiscal year by at least 5 percentage points, then the State's applicable percentage is 50 percent.

Arrearage Collections

Under paragraph (g), a State's arrearage collections performance level

for a fiscal year is equal to the total number of eligible IV-D cases in which payments of past-due child support were received and disbursed during the fiscal year, divided by the total number of IV-D cases in which there was past-due child support owed, as determined under §§ 305.2 and 305.32. The applicable percentage with respect to a State's arrearage collections performance level can be found on table 2, except as provided in paragraph (h).

Under paragraph (h), if the State's arrearage collections performance level for a fiscal year is less than 40 percent but exceeds the arrearage collections performance level for the immediately preceding fiscal year by at least 5 percentage points, then the State's applicable percentage is 50 percent.

TABLE 2.—IF THE CURRENT COLLECTIONS OR ARREARAGE COLLECTIONS PERFORMANCE LEVEL IS:

(Use this table to determine the maximum incentive levels for the current and arrearage support collections performance measures.)

At least: (percent)	But less than: (percent)	The applicable percentage is
80		100
79	80	98
78	79	96
77	78	94
76	77	92
75	76	90
74	75	88
73	74	86
72	73	84
71	72	82
70	71	80
69	70	79
68	69	78
67	68	77
66	67	76
65	66	75
64	65	74
63	64	73
62	63	72
61	62	71
60	61	70
59	60	69
58	59	68
57	58	67
56	57	66
55	56	65
54	55	64

TABLE 2.—IF THE CURRENT COLLECTIONS OR ARREARAGE COLLECTIONS PERFORMANCE LEVEL IS:—Continued

(Use this table to determine the maximum incentive levels for the current and arrearage support collections performance measures.)

At least: (percent)	But less than: (percent)	The applicable percentage is
53	54	63
52	53	62
51	52	61
50	51	60
49	50	59
48	49	58
47	48	57
46	47	56
45	46	55
44	45	54
43	55	53
42	43	52
41	42	51
40	41	50
0	40	0

Under paragraph (i), a State's cost-effectiveness performance level for a fiscal year is equal to the total amount of IV-D support collected and disbursed or retained, as applicable during the fiscal year, divided by the total amount expended during the fiscal year, as determined under §§ 305.2 and 305.32. The applicable percentage with respect to a State's cost-effectiveness performance level can be found on table 3.

TABLE 3.—IF THE COST-EFFECTIVENESS PERFORMANCE LEVEL IS:

(Use this table to determine the maximum incentive level for the cost-effectiveness performance measure.)

At least:	But less than:	The applicable (percent)
5.00		100
4.50	4.99	90
4.00	4.50	80
3.50	4.00	70
3.00	3.50	60
2.50	3.00	50
2.00	2.50	40
0.00	2.00	0

Because of the complexity of the incentives formula set forth in section 458A of the Act and implemented by these regulations, we have included an example of how the system will work in a particular year for State A:

Let's make the following assumptions regarding State A (See table A):

- State A's paternity performance level is 54 percent, making its applicable percent 64 percent (see table 1)
- State A's order establishment performance level is 79 percent, making its applicable percent 98 percent (see table 1)
- State A's current support collections performance level is 41 percent, making its applicable percent 51 percent (see table 2)
- State A's arrearage support collections performance level is 40 percent, making its applicable percent 50 percent (see table 2)
- State A's cost-effectiveness ratio is 3.00, making its applicable percent 60 percent (see table 3)
- State A's collections base is \$50 million (determined by 2 times the collections for Current Assistance and Former Assistance cases plus collections for other cases)
- The maximum incentive is:
 - \$32 million collections base for paternity (\$50 mil. times 0.64), plus
 - \$49 million collections base for orders (\$50 mil. times 0.98), plus
 - \$25.5 million collections base for current collections (\$50 mil. times 0.51), plus
 - \$18.8 million collections base for arrearage collections (\$50 million times 0.75 times 0.50) plus
 - \$22.5 million collections base for cost-effectiveness (\$50 million times 0.75 times 0.60) equals
 - Resulting in a maximum incentive base amount of \$147.8 million for State A.

TABLE A

Measure	State A's performance level	Applicable percent based on performance (percent)	Weight	State A's collection base (assumed to be \$50.0 million)
Paternity establishment	54%	64	1.00	\$32.0 million.
Order establishment	79%	98	1.00	\$49.0 million.

TABLE A—Continued

Measure	State A's performance level	Applicable percent based on performance (percent)	Weight	State A's collection base (assumed to be \$50.0 million)
Current collections	41%	51	1.00	\$25.5 million.
Arrearage collections	40%	50	0.75	\$18.8 million.
Cost-effectiveness	\$3.00	60	0.75	\$22.5 million.
State A's maximum incentive base amount				\$147.8 million.

- We must now make some assumptions regarding the other States. Let's assume that there are only two other States in our country—and the maximum incentive base amount is \$84 million for State B and \$50 million for State C, making the total maximum incentive base amount \$281.8 million for all three States (See table B).

- We must now determine what State A's share of the \$281.8 million is. It is 52 percent (\$147.8 divided by \$281.8)

TABLE B

State	Maximum incentive base amounts	State's share of \$281.8 million	Incentive payment pool \$422 million (in millions)
A	\$147.8	0.52	\$219.4
B	84.0	0.30	126.6
C	50.0	0.18	76.0
Totals	281.8	1.00	422.0

- Let us assume the incentive payment pool for the FY is \$422 million.

- Since State A's share is 0.52, this State has earned 52 percent of the \$422 million incentive payment pool that Congress is allowing, or \$219.4 (\$422 mil. times 0.52) million incentive payment for this particular fiscal year.

Section 305.34 Payment of Incentives

Section 458A(d) of the Act includes administrative provisions for estimating and paying incentives. Section 305.34 implements those provisions. Under paragraph (a), each State must claim/ include one-fourth of its estimated annual incentive payment on each of its four quarterly expenditure reports for a fiscal year. When combined with the other amounts reported on each of the State's four quarterly expenditure reports, the portion of the annual estimated incentive payment as reported each quarter will be included in the calculation of the next quarterly grant

awarded to the State under title IV–D of the Act.

Under paragraph (b), following the end of each fiscal year, HHS will calculate the State's annual incentive payment, using the actual collection and expenditure data and the performance data submitted by the State and other States for that fiscal year. To determine the final incentive amounts, OCSE will first audit State-reported data submitted by December 31, or if a data reliability audit has already been performed during that fiscal year, OCSE will confirm that no system's or other changes have occurred in the interim which may have affected the data reliability. A determination of reliability will be made. Because data reliability audits may have to be conducted for some States which did not take advantage of the opportunity for such audits to be conducted during the performance year, final calculation of the State's incentive award will be made in August using actual data and performance levels of the State and other States, factoring in any determinations of incomplete or unreliable data as provided in paragraph (c). Based on this calculation, a positive or negative grant will be awarded to each State under title IV–D of the Act to reconcile the actual annual incentive payment that for a fiscal year with the incentive payment estimated by the State during that year. We are encouraging states to be conservative in their estimates during the phase-in years for the new incentive system. This will decrease the likelihood that HHS will have to make large negative adjustments.

Under paragraph (c), payment of incentives is contingent on a State's data being determined reliable data by Federal auditors, consistent with the requirement for complete and reliable data set forth in section 458A(b)(5)(B) of the Act.

Section 305.35 Reinvestment

Section 458A(f) of the Act requires a State to use incentive payments to supplement and not supplant other funds used by the State in its IV–D

program, or otherwise with approval of the Secretary. Under § 305.35, which implements this requirement, paragraph (a) requires a State to expend the full amount of incentive payments received under the IV–D program to supplement, and not supplant other funds used by the States to carry out IV–D program activities; or funds for other activities approved by the Secretary which may contribute to improving the effectiveness or efficiency of the State's IV–D program, including cost-effective contracts with local agencies, whether or not the expenditures for the activity are eligible for reimbursement under title IV–D of the Act.

Under paragraph (b), in those States in which incentive payments are passed through to political subdivisions or localities, in accordance with section 454(22) of the Act and § 302.55, such payments must be used in accordance with this section.

Under paragraph (c), State IV–D expenditures may not be reduced as a result of the receipt and reinvestment of incentive payments.

In order to determine if incentive payments are used to supplement rather than supplant other amounts used by the State to fund the IV–D program, a base year level of program expenditures is necessary. Therefore, under paragraph (d), a base amount will be determined by subtracting the amount of actual incentives paid to the State which was reinvested in the IV–D program for fiscal year 1998 from the total amount expended by the State in the IV–D program during the same period. The rule also allows States, in the alternative, to use the average of the previous three fiscal years (1996, 1997, and 1998) as a base amount. This base amount of State spending will have to be maintained in future years. Incentive payments under this part are to be used in addition to, and not in lieu of, the base amount.

We selected fiscal year 1998 rather than fiscal year 1999 because we believe that the total for fiscal year 1999 may not be available until some time in fiscal year 2000 and we want States to know what their base amount that must be

maintained is in advance of receiving any incentive payments under section 458A. Additionally, we allow the States the alternative of computing a 3-year average. We used this alternative because we believe it might more closely approximate the amount a State has been spending on its IV-D program and will not give undue weight to any extraordinary or non-recurring expenditures that the State may have made in fiscal year 1998.

Based on comments from the proposed regulation, we eliminated the proposed examples under paragraph (e) and revised the language in paragraph (d) to clarify when incentive payments would be subtracted from FY 1998 expenditures. Most commenters found that the examples added an element of confusion to the base year calculation.

Under paragraph (f), that has been redesignated as the new paragraph (e), requests for approval of expending incentives on activities not currently eligible for funding under the IV-D program, but which would benefit the IV-D program (e.g., work programs for noncustodial parents), must be submitted in accordance with instructions issued by the Commissioner of the Office of Child Support Enforcement. We will develop and disseminate by Action Transmittal instructions for States seeking approval to expend incentives on activities that would benefit the IV-D program.

Section 305.36 Incentive Phase-In

Section 201(b) of the Child Support Performance and Incentive Act of 1998 establishes a transition period which phases in the new incentives system under section 458A of the Act. Under § 305.36, the incentive system under part 305 will be phased-in over a three-year period during which both the current system and the new system will be used to determine the amount a State will receive. For fiscal year 2000, a State will receive two-thirds of what it would have received under the incentive formula set forth in § 304.12, and one-third of what it would have received under the formula set forth under part 305. In fiscal year 2001, a State would receive one-third of what it would have received under the incentive formula set forth under § 304.12 and two-thirds of what it would have received under the formula under part 305. In fiscal year 2002, the formula set forth under part 305 will be fully implemented and will be used to determine all incentive amounts.

V. Description of Regulatory Provisions—Penalties and Audit

Former Audit and Penalty Process

In implementing the former requirement at section 452(a)(4) of the Act, the former regulations at part 305 required HHS to conduct an audit at least once every three years, to evaluate the effectiveness of each State's program in carrying out the purposes of title IV-D of the Act and to determine that the program met the title IV-D requirements. These audits were the sole basis for imposing a penalty under former section 403(h) of the Act.

The audits were a comprehensive review of all program requirements. A penalty was assessed in accordance with section 403(a) of the Act when the State failed the audit, but it was suspended during the period the State was under a corrective action plan. If the State passed the follow-up review, the penalty was not applied. In addition, HHS then conducted the comprehensive audit on an annual basis in the case of a State that was subject to a penalty. For a State operating under a corrective action plan, the review at the end of the corrective action period covered only the criteria specified in the notice of non-compliance.

Part 305 of the regulations was removed as part of an omnibus clean-up regulation designed to conform existing program regulations to mandatory changes made by PRWORA and subsequent laws. Since PRWORA and Pub. L. 105-200 significantly changed the audit and penalty provisions of the statute, we removed all of part 305. The clean-up regulation was published February 9, 1999 (64 FR 6237). We include this summary of the former Federal process, however, because under the revised audit and penalty provisions in sections 409(a)(8) and 452(a)(4) and (g) of the Act, the Secretary is required to assess a penalty if a State IV-D program is determined not to be in substantial compliance with IV-D requirements. As explained in greater detail later in this preamble, the process for making such a determination is based largely on the former audit and penalty standards and procedures.

New Audit and Penalty Process

Under section 409(a)(8) of the Act, if, based on the data submitted by the State for a review, the State program fails to achieve the paternity establishment or other performance standards set by the Secretary; or if an audit finds that the State data is incomplete or unreliable; or if the State failed to substantially comply with one or more IV-D requirements, and the State fails to

correct the deficiencies in the succeeding fiscal year following the performance year, then the amounts otherwise payable to the State under title IV-A will be reduced. However under section 409(a)(8)(C) of the Act, a State will be determined to be in substantial compliance with IV-D requirements if the Secretary determines that the noncompliance is of a technical nature which does not adversely affect the performance of the State's IV-D program, or will be determined to have submitted accurate data where the incompleteness or unreliability of the data is of a technical nature which does not affect the determination of the State's performance on the performance standards.

In these regulations, we have relied heavily on the well-established, tested and experienced Federal audit process, which was used for penalties assessed under the former section 403(h) of the Act and former part 305, to establish the new audit regulations. In fact, much of our language governing the audit process is taken almost verbatim from former part 305, particularly in sections dealing with the audit process, State responsibilities, definition of substantial compliance, and notice and assessment of the penalty.

Section 305.40 Penalty Performance Measures and Levels

Section 305.40 establishes the performance measures to be used to determine whether a State IV-D program is performing adequately to avoid a financial penalty under section 409(a)(8)(A)(i)(I) of the Act. As discussed earlier in this preamble, under paragraph (a), there are three performance measures for which States have to achieve certain levels of performance in order to avoid being penalized for poor performance. These measures are paternity establishment, support order establishment, and current collections as set forth in § 305.2 of these regulations.

The levels of performance that determine whether or not a State is subject to a penalty were established based on analysis of historical statistical and financial program data submitted by States. This program data was used to set the expected levels of performance and improvements, which are based on past State performance and reasonable expectations of improved performance. The expectations of performance in this rule were set taking into consideration State concerns, prior work done by State and Federal partners to develop the incentive system, and consultations with State partners about what

constituted reasonable performance levels supported by historical data.

The measures and levels of performance are:

(1) The *paternity establishment percentage* which is required under section 452(g) of the Act for penalty

purposes. States have the option of using either the IV-D paternity establishment percentage or the statewide paternity establishment percentage defined in § 305.2. Table 4 shows at which level of performance the State is subject to a penalty under the

paternity establishment measure. For example, if State A earned a paternity establishment percent of 34 percent and only improved by 3 percentage points over the previous fiscal year, then State A is subject to a penalty of 1–2 percent of TANF funds, for the first finding.

TABLE 4.—STATUTORY PENALTY PERFORMANCE STANDARDS FOR PATERNITY ESTABLISHMENT
(Use this table to determine the level of performance for the paternity establishment measure that will incur a penalty.)

PEP	Increase required over previous year's PEP	Penalty FOR FIRST FAILURE if increase not met
90% or more	None	No penalty.
75% to 89%	2%	1–2% TANF funds.
50% to 74%	3%	1–2% TANF funds.
45% to 49%	4%	1–2% TANF funds.
40% to 44%	5%	1–2% TANF funds.
39% or less	6%	1–2% TANF funds.

(2) The *support order establishment* performance measure to be used for penalty purposes is the measure defined in § 305.2. For purposes of the penalty with respect to this measure, there is a threshold of 40 percent, below which a State is penalized unless an increase of 5 percent over the previous year is achieved—which will also qualify it for an incentive. Performance in the 40 percent to 49 percent range with no significant increase will not be penalized, but neither will it qualify for an incentive payment. Table 5 shows at which level of performance a State will incur a penalty under the order establishment measure.

TABLE 5.—PERFORMANCE STANDARDS FOR ORDER ESTABLISHMENT
(Use this table to determine the level of performance for the order establishment measure that will incur a penalty.)

Performance level	Increase over previous year	Incentive/Penalty
50% or more	no increase over previous year required	Incentive/No Penalty.
40% to 49%	w/ 5% increase over previous year	Incentive/No Penalty.
	w/out 5% increase	No Incentive/No Penalty.
Less than 40%	w/ 5% increase over previous year	Incentive/No Penalty.
	w/out 5% increase	No Incentive/Penalty equal to 1–2% of TANF funds for the first failure, 2–3% for second failure, and so forth, up to a maximum of 5% of TANF funds.

(3) For the *current collections* performance measure, there is a threshold of 35 percent below which a State is penalized unless an increase of 5 percent over the previous year is achieved (that qualifies it for an incentive). Performance in the 35 percent to 40 percent range with no significant increase will not be penalized, but neither will it qualify for an incentive payment. Table 6 shows at which level of performance the State will incur a penalty under the current collections measure.

TABLE 6.—PERFORMANCE STANDARDS FOR CURRENT COLLECTIONS
(Use this table to determine the level of performance for the current collections measure that will incur a penalty.)

Performance level	Increase over previous year	Incentive/Penalty
40% or more	no increase over previous year required	Incentive/No Penalty.
35% to 40%	w/5% increase over previous year	Incentive/No Penalty.
	w/out 5% increase	No Incentive/No Penalty.
Less than 35%	w/5% increase over previous year	Incentive/No Penalty.
	w/out 5% increase	No Incentive/Penalty equal to 1–2% of TANF funds for the first failure, 2–3% for second failure, and so forth, up to a maximum of 5% of TANF funds.

Under paragraph (b), the provisions applicable to calculations listed under § 305.32, apply to the calculation of performance levels for penalty purposes, e.g., counting only disbursed collections, and double-counting interstate collections.

Section 305.42 Penalty phase-in

Section 305.42 sets a schedule for phasing in the new penalty provisions which relates to the incentive phase-in under § 305.36. States will be subject to penalties for poor performance as of

fiscal year 2001. States are subject to the performance penalties based on data reported for FY 2001. Data reported for

FY 2000 will be used as a base year to determine improvements in performance during FY 2001. There is an automatic statutory corrective action period of one fiscal year immediately succeeding the performance year before any penalty will be imposed. If at the end of the corrective action period the deficiency is not corrected, the penalty will be taken. For example, if the Secretary finds with respect to FY 2001, that the State had either failed to achieve the level of performance required or that the State's FY 2001 data was unreliable or incomplete, then the State would be required to correct the deficiency and meet the performance measure during the succeeding year, i.e., FY 2002. If the State has either unreliable or incomplete data or fails the performance measure for the corrective action year, FY 2002, a penalty will be assessed.

Since States' performance will be measured on the basis of the States' own data, a State should be expected to continually monitor its progress toward meeting the performance standards during the course of the year. Similarly, States should continuously monitor their own data for completeness and reliability. OCSE will conduct a data reliability audit for a State during the year upon request by a State and will assess performance, based upon the data submitted by the State, as soon as it is reported at the end of the year. States are on notice, however, that any corrective action which may be necessary to correct either a data or a performance deficiency must be achieved before the end of the fiscal year immediately succeeding the performance year.

Section 305.60 Timing and scope of federal audits

Based on explicit statutory requirements at sections 452(a)(4)(C) and 409(a)(8)(A)(i)(II) of the Act, under § 305.60 OCSE will conduct audits, in accordance with the Government auditing standards of the Comptroller General of the United States—

(1) At least once every three years (or more frequently if the State fails to meet performance standards and reliability of data requirements) to assess the completeness, authenticity, reliability, accuracy and security of data and the systems used to process the data in calculating performance indicators under part 305;

(2) To determine the adequacy of financial management of the State IV-D program, including assessments of:

(i) Whether funds to carry out the State program are being appropriately

expended, and are properly and fully accounted for; and

(ii) Whether collections and disbursements of support payments are carried out correctly and are fully accounted for; and

(3) For such other purposes as the Secretary may find necessary, including audits to determine if the State is substantially complying with one or more of the requirements of the IV-D program (with the exception of the requirements of section 454(24) of the Act relating to statewide-automated systems of section 454(27)(A) or (B)(i) relating to the State Disbursement Units).

If a data reliability audit has been performed during the prior year, OCSE will conduct a limited review to determine whether any systems or other changes have occurred which may have affected data reliability or completeness. A State may request a data reliability audit at any time during the year as such reviews do not necessarily require analysis of the full year's data.

Substantial compliance audits are defined in § 305.63 and are discussed later in this preamble. Under these rules the substantial compliance audits will be conducted at the discretion of the Secretary, and are triggered based on substantiated evidence of a failure by the State to meet IV-D program requirements. The evidence that might warrant such an audit to determine substantial compliance include:

(i) The results of 2 or more sequential State self-reviews conducted under section 454(15)(A) of the Act which show evidence of sustained poor performance or indicate that the State has not corrected deficiencies identified in previous self-assessments and that these deficiencies are determined to seriously impact the performance of the State's program; or

(ii) Evidence of a State program's systemic failure to provide adequate services under the program through a pattern of non-compliance over time.

While we recognize the advantage and responsibility to maintain the authority to conduct audits similar to those which resulted in improved State performance in years past, we are committed to the philosophy which focuses on measuring program results, and allowing States the flexibility and responsibility to manage their own programs, while assuring that Federal requirements are met. We expect States to take the self-reviews to determine compliance with IV-D requirements seriously and to use those processes to continually critique and adjust their programs to ensure that children and families are adequately served. These Federal process audits

authorized under section 452(a)(4)(C) of the Act provide a fall back measure for the Secretary's use should systemic or serious problems with IV-D programs become apparent.

The Child Support Performance and Incentive Act of 1998, Pub. L. 105-200, established a specific financial penalty for a State's failure to meet statewide-automated systems requirements in section 454(24) of the Act. As a conforming amendment, section 409(a)(8) of the Act was amended to preclude a financial penalty under that section for failing to meet automated systems requirements under section 454(24) of the Act.

Similarly, the Consolidated Appropriations Act for FY 2000, Pub. L. 106-113, established an alternative penalty for States that fail to comply with the State Disbursement Unit (SDU) requirements under section 454(27)(A) and (B)(i) of the Act. As a conforming amendment, section 409(a)(8) of the Act was also amended to preclude a financial penalty under that section for failing to meet automated systems requirements under section 454(27)(A) or (B)(i).

While compliance with particular systems requirements will be excluded from any Federal audit to determine substantial compliance with IV-D requirements, States must still have complete and reliable data and meet the individual IV-D program requirements being audited, as defined in § 305.63, in order to avoid a financial penalty under § 305.61. These program requirements exist independently from the systems requirements under section 454(24) of the Act and, therefore, States will be held accountable for compliance.

Under paragraph (b), as with past audits, during the course of the audit, OCSE will make a critical investigation of the State's IV-D program through inspection, inquiries, observation, and confirmation and use the audit standards promulgated by the Comptroller General of the United States in "Government Auditing Standards."

Section 305.61 Penalty for failure to meet IV-D requirements

To implement the requirements of section 409(a)(8) of the Act, under paragraph (a) of § 305.61, a State is subject to a financial penalty and the amounts otherwise payable to the State under title IV-A of the Act would be reduced:

If, on the basis of:

(i) Data submitted by the State or the results of an audit conducted under § 305.60, the State's program failed to achieve the paternity establishment

percentages, as defined in section 452(g)(2) of the Act and § 305.40, or to meet the support order and current collections performance measures set forth in § 305.40; or

(ii) The results of an audit under § 305.60, the State did not submit complete and reliable data, as defined in § 305.1; or

(iii) The results of an audit under § 305.60, the State failed to substantially comply with one or more of the requirements of the IV-D program, as defined in § 305.63;

And, with respect to the corrective action year immediately following such failure, the State failed to take sufficient corrective action to achieve the appropriate performance levels or compliance or the data submitted by the State are still incomplete or unreliable.

A penalty will be applied only if the State failed to correct any identified deficiencies by the end of this automatic corrective action year. For example, if a State fails the PEP in fiscal year 2001, it must have reliable data and meet the PEP in the succeeding fiscal corrective action year—meaning it must meet the PEP standard for fiscal year 2002 or face a penalty in fiscal year 2003.

Under paragraph (b) of § 305.61, the penalty reductions described under § 305.61(c) (discussed below) will be made for quarters following the end of the automatic corrective action fiscal year following the fiscal year with respect to which the State submitted unreliable or incomplete data or failed the performance measure or was determined not to be in substantial compliance. The penalty will continue until the beginning of the first quarter following the end of the first quarter throughout which the State, as appropriate:

(1) Has achieved the paternity establishment percentages, the order establishment or the current collections performance measures defined in § 305.40; and

(2) Has submitted data that is complete and reliable; or

(3) Is in substantial compliance with the IV-D requirements audited for substantial compliance, as defined in § 305.63.

A State must have reliable and complete data and meet the performance standards in order to avoid imposition of a penalty following the end of the automatic corrective action year.

It is important to note that the statute at section 409(a)(8)(A) of the Act and these regulations clearly require States to submit complete and reliable data for all of the performance measures under sections 452(g) and 458 or incur

financial penalties. However, unlike other penalty circumstances, penalties for incomplete or unreliable data will also result in a loss of incentives. When data is incomplete or unreliable, it will be impossible to accurately determine the State's level of performance to either pay incentives or to assess performance. In such cases, a State's data must be complete and reliable by the end of the succeeding fiscal year and must demonstrate that the submitted data meets the performance measures in order to avoid the imposition of a penalty. Correcting incomplete or unreliable data within the automatic one-year corrective action period is not enough; the data must also show that the State performed at a high enough level during the corrective action year to avoid a financial penalty. For example, say a State is determined to have unreliable *current collection performance* data for FY 2001 and the State corrects the unreliable data for FY2001 during FY 2002. The State must still have reliable FY2002 data and meet the *current collection performance* standard for FY 2002 or incur a penalty in FY2003.

It should be noted, with reference to the example above, that the State may need to correct and resubmit its FY2001 data in order to demonstrate improvement which would qualify for incentives or to meet the penalty performance measure during FY2002. If the State will otherwise achieve the minimum performance level without showing an increase over the prior year, then correction of FY2001 data would be unnecessary.

Paragraph (c) sets forth the penalty levels from section 409(a)(8)(B) of the Act under which the payments for a fiscal year under title IV-A of the Act will be reduced by the following percentages:

(1) One to two percent for the first finding;

(2) Two to three percent for the second consecutive finding; and

(3) Not less than three percent and not more than 5 percent for the third or a subsequent consecutive finding.

These section 409(a)(8) penalties, which increase with each subsequent finding, are based upon penalties assessed under the former audit and penalty process in former section 403(h) of the Act. In actual practice, OCSE has used the lower amount for each situation.

Because the penalty is taken as a percentage of the amount payable to the State under part A of title IV, certain provisions applicable to other TANF penalties also apply to this penalty. The provisions in section 409(d) of the Act

which provide that the total penalties that may be taken may not exceed 25 percent of the TANF grant applies. In addition, section 410 of the Act provides for appeals when penalties are taken pursuant to section 409 of the Act.

Finally, section 409(a)(12) of the Act which requires that a State spend additional funds to replace the reductions in funds resulting from the imposition of a penalty applies. The TANF regulations published April 12, 1999 at 64 FR 17720 and effective October 1, 1999, contain provisions in new 45 CFR part 262 which address and implement these statutory provisions. We incorporate those provisions by cross reference.

Section 305.62 Disregard of a failure which is of a technical nature.

Section 409(a)(8)(C) of the Act, like the former section 403(h) of the Act, recognizes that certain noncompliance may be insufficient to significantly impact a State's performance or data reliability. Under § 305.62, we implement this concept by providing that a State subject to a penalty under § 305.61(a)(1)(ii) or (iii) may be determined, as appropriate, to have submitted adequate data or to have achieved substantial compliance with one or more IV-D requirements, as defined in § 305.63 (discussed below), if the Secretary determines that the incompleteness or unreliability of the data, or the noncompliance with one or more of the IV-D requirements, are of a technical nature which does not adversely affect the performance of the State's IV-D program or does not adversely affect the determination of the level of the State's paternity establishment or other performance measure percentages.

Section 305.63 Definition of substantial compliance with IV-D requirements.

Because section 409(a)(8) of the Act requires the assessment of a penalty should a State be found, as a result of an audit, to have failed to substantially comply with one or more IV-D requirements which it fails to correct in the corrective action year, we must provide a definition of substantial compliance that will be used by the auditors to measure State compliance with IV-D requirements. Former § 305.20 established, for purposes of the former Federal audit and penalty process, the definition of an effective program in substantial compliance with the requirements of title IV-D of the Act. Therefore, under § 305.63 we use the definition under former § 305.20 as the basis for a determination that a State

failed to achieve substantial compliance with one or more IV-D requirements.

However, there is one significant difference between the new and former audit and penalty process which deals with the required scope of the audit. Under the former statute and regulations, a penalty was based on a complete audit of a State's program for substantial compliance with all of the applicable IV-D requirements. Under section 408(a)(9) of the Act and these regulations, a State may be audited on one, some, or all of the requirements and may be assessed a penalty, if it is found not to comply with one or more IV-D requirements. Assessment of a penalty could be based, therefore, on a targeted audit of specific IV-D requirements. Specifically, for the purposes of a determination under § 305.61(a)(1)(iii), in order to be determined in substantial compliance with one or more of the IV-D requirements as a result of an audit conducted under § 305.60, a State is required to meet the specific IV-D State plan requirement or requirements that were audited. The IV-D requirements subject to audit are contained in part 302 of program regulations, and are measured as described in the following paragraphs.

Under paragraph (a), the State must meet all the requirements under any of the following areas being audited:

Statewide operations, § 302.10;
Reports and maintenance of records, § 302.15(a);
Separation of cash handling and accounting functions, § 302.20; and
Notice of collection of assigned support, § 302.54.

These areas are identical to those in former § 305.20, which measured management and accountability of the program.

Under paragraph (b), the State is required to meet the requirements under the following areas in at least 90 percent of the cases reviewed for each criterion being audited, consistent with the requirements used under the former § 305.20:

Establishment of cases, § 303.2(a); and
Case closure criteria, § 303.11.
We believe these criteria should continue to be met in 90 percent of cases reviewed because of their critical nature. They are intended to ensure that cases are opened and closed appropriately.

Under paragraph (c), States will be held to the same test they have been held to under former audit and penalty requirements in place and used since the early to mid-1990s. Under the paragraph, the State is required to meet the following areas in at least 75 percent

of the cases reviewed for each criterion being audited:

(1) Collection and distribution of support payments, including: collection and distribution of support payments by the IV-D agency under § 302.32(b); distribution of support collections under § 302.51; and distribution of support collected in title IV-E foster care maintenance cases under § 302.52;

(2) Establishment of paternity and support orders, including: establishment of a case under § 303.2(b); services to individuals not receiving TANF or title IV-E foster care assistance, under § 302.33(a)(1) through (4); provision of services in interstate IV-D cases under § 303.7(a), (b) and (c)(1) through (6) and (8) through (10); location of non-custodial parents under § 303.3; establishment of paternity under § 303.5(a) and (f); guidelines for setting child support awards under § 302.56; and establishment of support obligations under § 303.4(d), (e) and (f);

(3) Enforcement of support obligations, including, in all appropriate cases: establishment of a case under § 303.2(b); services to individuals not receiving TANF or title IV-E foster care assistance, under § 302.33(a)(1) through (4); provision of services in interstate IV-D cases under § 303.7(a), (b) and (c)(1) through (6) and (8) through (10); location of non-custodial parents under § 303.3; enforcement of support obligations under § 303.6 and State laws enacted in accordance with section 466 of the Act, including submitting once a year all appropriate cases in accordance with § 303.6(c)(3) to State and Federal income tax refund offset; and income withholding under § 303.100. In cases in which income withholding cannot be implemented or is not available and the non-custodial parent has been located, States must use or attempt to use at least one enforcement technique available under State laws in addition to Federal and State tax refund offset, in accordance with State laws and procedures and applicable State guidelines developed under § 302.70(b) of this chapter;

(4) Review and adjustment of child support orders, including: establishment of a case under § 303.2(b); services to individuals not receiving TANF or title IV-E foster care assistance, under § 302.33(a)(1) through (4); provision of services in interstate IV-D cases under § 303.7(a), (b) and (c)(1) through (6) and (8) through (10); location of non-custodial parents under § 303.3; guidelines for setting child support awards under § 302.56; and review and adjustment of support obligations under § 303.8;

(5) Medical support, including: establishment of a case under § 303.2(b); services to individuals not receiving TANF or title IV-E foster care assistance, under § 302.33(a)(1) through (4); provision of services in interstate IV-D cases under § 303.7(a), (b) and (c)(1) through (6) and (8) through (10); location of non-custodial parents under § 303.3; securing medical support information under § 303.30; and securing and enforcing medical support obligations under § 303.31; and .

(6) Disbursement of support payments in accordance with the timeframes in section 454B of the Act or the regulation at § 302.32.

Except for the last requirement for disbursement of support collected within the timeframe set forth in requirements for a State Disbursement Unit in section 454B of the Act, the provisions are taken from the former § 305.20. We are using those standards because we still consider them to represent the critical aspects of IV-D program requirements and believe they are essential to any determination of substantial compliance with any of the requirements being audited for that purpose. The subparagraphs, as written, are broad and incorporate revised provisions of title IV-D of the Act, such as any changes in distribution, additional enforcement techniques, revised review and adjustment procedures and evolving medical support expectations that are indicated in the statute or regulations.

The timeframe for disbursement of support collections by the State Disbursement Unit under section 454B of the Act is included because it is one of the essential case processing timeframes added by PRWORA. Other explicit requirements of PRWORA are included by reference to laws enacted under section 466 of the Act and still others, for example, the State Directory of New Hires and other new locate sources, will be evaluated as part of the State's automated system certification.

As with the former audit process which recognized that citing States for each failure to meet a specific timeframe could remove a State's motivation to move forward in such a case, we propose to adopt the provisions from former § 305.20 under which States can receive credit for a case being reviewed if they accomplish the necessary action within the audit period, despite having missed an interim timeframe. We remain committed to this concept in these regulations and have incorporated it into paragraph (d).

Finally, as under the former audit standards in § 305.20, paragraph (e) requires a State to meet the

requirements for expedited processes under § 303.101(b)(2)(i) and (iii), and (e).

Under the new penalty standards in section 409(a)(8) of the Act and the new audit responsibilities under section 452(a)(4) of the Act, the Federal audit and subsequent penalty can cover simply one, or a number of IV-D requirements. Using the definition of substantial compliance described above, Federal auditors, States and other interested parties will be aware of the expected level of State performance with respect to any particular requirement being audited.

Section 305.64 Audit procedures and State comments

This section will adopt the same procedures as were in effect under former § 305.12. Under paragraph (a), prior to the start of the actual audit, whether for data reliability and completeness or for substantial compliance, Federal auditors will hold an audit entrance conference with the State IV-D agency. At that conference, the auditors will explain how the audit will be performed and make any necessary arrangements.

Under paragraph (b), at the conclusion of audit fieldwork, Federal auditors will afford the State IV-D agency an opportunity to have an audit exit conference at which time preliminary audit findings will be discussed and the State IV-D agency may present any additional matter it believes should be considered in the audit findings.

Under paragraph (c), after the exit conference, Federal auditors will prepare and send to the State IV-D agency, a copy of an interim report on the results of the audit. Within a specified timeframe from the date the report was sent by certified mail, the State IV-D agency will be able to submit written comments on any part of the report that the State IV-D agency believes is in error. The auditors will note such comments and incorporate any response into the final audit report.

Section 305.65 State cooperation in audit

Also consistent with historic State responsibilities with respect to Federal audits, we incorporated former § 305.13 and require that each State make available to the Federal auditors such records or other supporting documentation (electronic and manual) as the audit staff may request, including records to support the data as submitted on the Federal statistical and financial reports that will be used to calculate the State's performance. On-line access to a

State's system and data will expedite the process for both the Federal auditors and the States. We have included specific reference to the data States must submit because it is essential to the auditors' work. States will also be required to make available personnel associated with the State's IV-D program to provide information that the audit staff may find necessary in order to conduct or complete the audit.

We also require, under paragraph (b), that States provide evidence to OCSE that their data are complete and reliable. This ensures the responsibility for maintaining and providing reliable data is the State's responsibility.

As was the case under former audit regulations at § 305.13, we require in paragraph (c), that failure to comply with the requirements of this section with respect to audits conducted under § 305.64 may necessitate a finding that the State has failed to comply with the particular criteria being audited. State cooperation with the audit is essential to assess performance. In addition, States are encouraged to provide Federal auditors with on-line access to their systems and data. On-line access to a State's system and data will expedite the process for both the Federal auditors and the States.

Section 305.66 Notice, corrective action year, and imposition of penalty for failure to meet requirements

Section 305.66 addresses notice to the State of any deficiency or deficiencies identified. Similar to the notice aspects of the former audit process at former § 305.99, paragraph (a) requires that, if the Secretary, on the basis of the results of an audit or review, finds a State to be subject to a penalty, OCSE will notify the State in writing of such finding.

Under paragraph (b), the notice will:

- (1) Explain the deficiency or deficiencies which result in the State being subject to a penalty, indicate the amount of the potential penalty, and give reasons for the Secretary's finding; and
- (2) Specify that the penalty will be assessed if the State has failed to correct the deficiency or deficiencies cited in the notice during the succeeding fiscal year, referred to as the "corrective action" year. The corrective action year is the fiscal year immediately following the year with respect to which the deficiency occurred.

The State should be continuously monitoring its own performance and taking action to improve performance which its own data shows may fail to achieve the performance measures. The State is also responsible for maintaining proper procedures and controls to

ensure data reliability and completeness. OCSE is willing to conduct data reliability audits at any time during the compliance year, but the State should not wait or rely upon the Secretary's determination of a data or a performance deficiency in order to begin corrective action. Two consecutive years of failure (either poor data or poor performance) in the same performance measure criterion will trigger a penalty imposition.

As discussed earlier in the preamble, the imposition of a penalty is subject to certain limitations, appeals and replacement of funds requirements specified in sections 409 and 410 of the Act. We incorporate those statutory requirements in paragraph (b)(2) by cross reference to the specific TANF regulatory provisions in 45 CFR part 262 that implement those requirements.

Under paragraph (c), the penalty will be assessed if the Secretary determines that the State has not corrected the deficiency or deficiencies cited in the notice by the end of the corrective action year. This determination will be made as soon as possible after the end of the corrective action year. The penalty will be assessed, however, commencing with the first quarter following the end of the corrective action year. The statute requires that the penalty must be imposed for a minimum period of one quarter, but may be suspended "following the end of the first quarter throughout which the State program has achieved * * * (compliance)."

We require, as supported by the language of section 409(a)(8) of the Act, under paragraph (d), that only one corrective action period be provided to a State in relation to a given deficiency when consecutive findings of noncompliance are made on that deficiency.

Under paragraph (e), a consecutive finding occurs only when the State does not meet or achieve substantial compliance with the same criterion or with any one of the criteria cited in the notice. A new corrective action year will be triggered by a data deficiency or performance failure under a different criterion than was cited in the prior penalty notice.

VI. Response to Comments

We received twenty-eight comments from representatives of State IV-D agencies, national organizations, and advocacy groups on the proposed rule published October 8, 1999 in the **Federal Register** (64 FR 55074). A summary of the changes made in response to comments is followed by a

summary of the comments received and our responses follows:

Changes Made in Response to Comments

OCSE carefully considered the comments received and made some changes to the final regulation in response. Section 303.35 dealing with the administrative complaint procedure was revised and clarified. Section 305.1(i) on the definition of data reliability was further clarified by including a 95 percent standard for data reliability to be effective for data reported for fiscal year 2001. Section 305.32(f) was revised to add a deadline of December 31 of each calendar year by which date complete and reliable data for the prior fiscal year necessary to compute the prior fiscal year's performance must be submitted to OCSE or the State will not receive incentives for that prior fiscal year. The example of the incentives calculation was removed from the regulation language. The two examples for determining a base year for the reinvestment requirement were removed.

Comments to Section 303.35 Administrative complaint procedure

We received twenty-six comments on the administrative complaint procedure from State IV-D agencies, national organizations and advocacy groups. Of these comments, four expressed strong support for the proposed review procedure and twenty-two expressed opposition to the proposal. Most of those expressing support were advocacy groups. In expressing support for the proposed review process, four commenters stated that the process would appropriately hold IV-D agencies accountable in individual cases, would improve customer satisfaction, would increase efficiency and expedite resolution of individual problems, and could help States identify systemic problems. However, in order to strengthen the proposed review process, these commenters made several suggestions for additions to the regulation.

The twenty-two commenters in opposition to the proposal were from State IV-D directors. Most of these requested that § 303.35 be removed from the final regulations.

We believe that an administrative complaint procedure is an essential component in the child support program. The rule does not dictate how States must implement the complaint procedure. We recognize that many States may already have these procedures in place. The rule sets minimal requirements and States are

able to set their own procedures. We have revised the regulatory language to state that an administrative complaint procedure must be in place "as defined by the State." We have addressed individual concerns in the following responses and have revised the regulatory language to address the objections. The comments and our responses are as follows:

1. *Comment:* Three commenters suggested the addition of a specific deadline for State IV-D agencies in responding to client complaints and notifying the complainant of the review determination.

Response: We have not adopted this suggestion to include in the regulation a specific time deadline for response and notification. The intent of this regulation is to ensure that all State IV-D programs have a review process in place, not to dictate specific requirements for States in implementing their complaint procedures.

2. *Comment:* Three commenters recommended the addition of a requirement for State IV-D agencies to establish procedures for informing clients about the availability of the review process.

Response: We have included this suggestion in the regulation, in order to ensure that recipients of IV-D services are informed of the State's review process. We would encourage all States to include this notification in the initial information provided to applicants and those referred for program services.

3. *Comment:* Two commenters suggested we add an analysis of types and origins of complaints as a required element in the State's self-assessment report to allow for the identification and correction of systemic problems.

Response: We have chosen not to include analysis of complaints as required element in the State self-assessment report. However, we would encourage States to regularly examine the types of complaints they are receiving in order to identify and correct any chronic or systemic problems. This examination of complaints could be included in the optional program service enhancements section of the State self-assessment, with a description of practices initiated by the State that are contributing to improved program performance and customer service. In order to assess the need for any future program improvements, we will monitor State implementation of the administrative complaint procedure and seek input from States and other stakeholders.

4. *Comment:* One commenter recommended we require the reviews to be conducted by an independent

decision-maker to enhance the credibility and fairness of the process. In so doing, this commenter cited the California statute that includes such a provision.

Response: We have not adopted this recommendation as we are not convinced that an independent decision-maker is necessary to ensure fairness and we wish to provide the maximum flexibility to States in designing and implementing their administrative review procedures. States may utilize an independent reviewer to maximize fairness and due process for all parties involved.

5. *Comment:* Eighteen commenters stated that the proposed regulation is unnecessary as most States already have complaint procedures in place. One commenter stated further that the regulation may create confusion regarding existing State procedures and whether they are/are not in compliance with the new regulation. One commenter stated that, due to existing State procedures, the regulation would provide no new protections for clients but would add administrative burdens to the State. Finally, one commenter stated that each State should be free to set its own complaint procedures.

Response: We believe that an administrative complaint procedure is an essential component in the move to a program based on outcomes and performance-based incentives and penalties. Recipients of services, through administrative complaint processes, should be able to access the IV-D agency and lodge complaints when they have evidence to support specific concerns in their cases. It is not our intent to nor does the rule dictate how States must implement the complaint procedure or to require States to replace their existing procedures with a more formal process. We recognize that many States may already have these procedures in place and do not intend to place additional burdens on those States with these requirements. The rule sets minimal requirements and States are able to set their own procedures. We have revised the regulatory language to state that an administrative complaint procedure must be in place "as defined by the State."

6. *Comment:* Sixteen commenters expressed concern that the proposed regulation would divert fiscal and personnel resources away from the primary IV-D mission. One commenter stated further that this diversion of resources could ultimately result in decreased agency efficiency and customer service. Ten commenters stated further that resources might be drained due to the potential for abuse of

the system by custodial parents who submit repeated complaints, requiring multiple reviews in each case. One commenter stated further that, as a result of this proposal, programs would have difficulty meeting major program goals, with the result of deficient performance in critical program areas. Finally, one commenter requested a more thorough analysis of the costs associated with this proposed regulation.

Response: Since most States already have procedures in place, as asserted in comment #1, this regulation would not require additional resources for them—they may continue with their existing procedures. In establishing their procedures, States have the ability to establish parameters for appropriate complaints and to, therefore, avoid excessive or repeated reviews in a case. For States that do not currently have a complaint procedure in place, this regulation will require some additional resources. However, we feel strongly that customer service and a process for administrative reviews are critical program areas consistent and supportive of the program's mission. Further, we believe that the 66 percent Federal funding of State IV–D programs should allow for sufficient funding to address this requirement.

7. *Comment:* Ten commenters stated that the language of the proposed § 303.35 is vague and overly broad, allowing multiple interpretations and increasing the potential for abuse of the complaint system. Two commenters specifically cited the regulatory language “appropriate action” and “resolving” as examples of this vague, broad language. Two commenters specifically requested that the second sentence in paragraph (a), which stated that the State “must have a procedure for reviewing the individual's complaint and resolving it where appropriate action was not taken”, be deleted in order to eliminate the vague language of “resolving” and to require a simpler case review upon request.

Response: To address these concerns, we revised the regulatory language to eliminate reference to resolving complaints but retain language to require States to take any appropriate action. The intent of this regulation is to allow customers a process for having their cases reviewed if an error has occurred and not to require formal administrative hearing processes or adjudication of complaints. We recognize that “resolution” of all complaints would be subject to interpretation. States determine appropriate action in IV–D cases and the complaint procedures is intended to

remedy errors, not to allow individuals to dictate actions in a case.

8. *Comment:* Nine commenters opposed this provision on the basis that it is beyond the scope and intent of the statute. One commenter, in referencing congressional intent, specifically cited provisions similar to this regulation that were in welfare reform bills that were rejected prior to the passage of PRWORA. One commenter states that the provision may also be unconstitutional.

Response: Section 1102 of the Act provides the authority to publish regulations that the Secretary deems necessary for the efficient administration of the IV–D program. Using this authority, we remain committed to requiring the administrative complaint procedures as we believe they are a necessary component in the program shift under PRWORA to performance-based incentives and State self-reviews. PRWORA revised Federal audit requirements from a process-based system to a performance-based system. The administrative complaint procedure represents a key element to identify case management problems that would have been captured in the previous, process-based audit system. We have included the administrative complaint procedure in this final rule because these regulations implement this program shift toward a performance-based, rather than process-based system. In the absence of clear legislative statements to the contrary, we do not believe that the failure to enact these administrative complaint procedures in PRWORA was intended to preclude the Secretary from using her regulatory authority under section 1102 of the Act. In addition, we do not believe there is any basis upon which to conclude that this provision would be unconstitutional.

9. *Comment:* Eight commenters referenced the Supreme Court decision in the *Blessing v. Freestone* case, stating that the proposed administrative complaint procedure would conflict with the Supreme Court decision in this case. Two additional commenters state that the proposed regulation would infer an “individual right of action”, but do not specifically reference the *Blessing v. Freestone* case. Five additional commenters expressed a concern that this regulation would result in increased litigation against the State IV–D agency.

Response: The United States Supreme Court, in the case of *Blessing v. Freestone*, 520 U.S. 329 (1997), ruled unanimously that title IV–D did not create an individually enforceable right to force States to “substantially comply” with all of the requirements of the IV–

D program. The administrative complaint procedure established under § 303.35 does not conflict with the Court's decision in that case, nor does it establish or infer an “individual right of action” to pursue judicial remedies for failure to provide specific IV–D services. We believe that establishment of such administrative procedures will, in fact, result in a decreased risk of litigation against the State IV–D agency based upon alleged failure of the State to provide specific services required under the statute and implementing regulations. Many of the requirements of title IV–D are concrete, mandatory, and binding upon the State and local agencies. For example, time limits which have been established for certain provision of services, distribution of support, and the like, could be construed as establishing enforceable rights. The establishment of an administrative complaint procedure, however, does nothing substantively to enhance or otherwise affect such rights as may already exist under title IV–D. The establishment of such procedures merely requires that the State have “administrative” pre-judicial review procedures to determine, and possibly correct, failures to take particular actions which may have been required under existing IV–D rules.

The State has broad discretion to determine what sort of an administrative complaint procedure it chooses to establish. We believe that most States, in fact, already have adequate procedures in place and that this new rule may impose virtually no additional requirement or burden on their program operations. In those States which have not established any mechanism for responding to complaints arising from parents' concern that certain mandatory actions have been delayed or were not taken at all, we believe that creating a forum to review such allegations will lead to increased customer satisfaction and should actually reduce the risk of judicial challenges to the State IV–D program.

10. *Comment:* Six commenters expressed concern that this provision would remove State discretion in determining and using the most appropriate enforcement tools. Instead, the provision would allow the customers to dictate enforcement in their cases.

Response: We disagree that this provision would allow customers to dictate enforcement or would remove appropriate State discretion. The rule does not mandate that the State take any particular action in response to a complaint. States will continue to have

responsibility for determining and using the appropriate actions and enforcement tools in a particular case in accordance with Federal regulations. This regulation is simply intended to allow recipients of IV-D services a mechanism for requesting a review of their cases when there is evidence that an action should have been taken by the IV-D agency. For example, a IV-D customer might request a review if he or she has provided information to the IV-D agency on the obligated parent's place of employment, but no action has been taken within federally required timeframes to institute wage withholding.

11. *Comment:* Four commenters stated that OCSE has provided inadequate documentation to justify the need for regulation in this area. Three commenters proposed further that OCSE and the States work together on this proposal to assess the need for regulation. One of these commenters suggested that OCSE convene a national workgroup to assess the need for regulation and, if necessary, draft more explicit regulatory language. Finally, one commenter requested a more thorough analysis of the costs associated with this proposed regulation.

Response: OCSE remains committed to partnership with States and consultation with our stakeholders. However, we are also committed to prioritizing customer service and feel that this regulation is necessary to ensure appropriate service for all IV-D customers. We will work with States to provide technical assistance and share best practices for implementing administrative complaint procedures. In this process, we will seek input from States and other stakeholders for further improvements.

12. *Comment:* Four commenters questioned OCSE's decision to regulate in this area, citing the recent commitment of OCSE and HHS to avoid unnecessary regulations.

Response: OCSE believes these requirements are necessary to ensure IV-D customers are given opportunities to raise concerns about their cases. We have drafted language that we believe imposes minimal requirements and allows maximum State flexibility in adopting and implementing administrative complaint procedures.

13. *Comment:* Four commenters expressed concern regarding the language "actions not taken," fearing a potential for litigation or abuse of the system. One commenter requested that, if the entire section 303.35 is not removed, that this "action not taken" language be removed from the final regulations.

Response: We agree with the concern that the proposed regulatory language was subject to multiple interpretations. Thus, we have revised the language "action taken, or not taken" that appeared in the NPRM to provide that individuals may request a review when there is evidence that an action should have been taken in their particular cases. The language now reads: "Each State must have an administrative complaint procedure, defined by the State, to allow individuals the opportunity to request an administrative review, and must take appropriate action if there is evidence that an error has occurred or an action should have been taken on a case." This final rule will ensure that all States have administrative complaint procedures in place and that recipients are notified of the availability of services and the outcome of the review, but will also allow States the flexibility to define their own administrative complaint procedures.

14. *Comment:* Four commenters asserted that the administrative review requirement would eliminate the efficiency gained by automated systems by essentially returning case management to a case-by-case review.

Response: While it is true that this regulation will require some case review, we disagree that it will eliminate the efficiency of the automated systems. The majority of cases will continue to be handled through automation. This regulation will require case review only in specific instances when the customer requests a review in accordance with State-established procedures. In these instances, we believe case review is appropriate in order to ensure the best possible case management and ensure maximum child support collections for children and families.

15. *Comment:* Two commenters expressed concern that the complaint process implies a requirement for 100% caseload compliance, rather than "substantial" compliance.

Response: These requirements are not intended as an avenue for IV-D customers to lodge complaints without a basis of concern. If the State is taking appropriate actions, in accordance with Federal requirements and its own State procedures, there should be no basis for lodging a complaint. States are expected to comply with Federal requirements in all cases. However, they will only be penalized when they are not in substantial compliance.

16. *Comment:* Two commenters expressed concern that the purpose of the proposed rule is to create a specific measure of State performance, but the

proposed rule did not include any specifics regarding the method of measurement for State performance.

Response: The intent of this regulation is to ensure that all State IV-D agencies have a complaint system in place. We believe that recipients of services should be able to access the IV-D agency and lodge complaints when they have specific concerns in their cases. However, the administrative complaint procedure is not intended to be used as a specific, quantitative measure of State performance. Nor does the complaint procedure convert the measure of substantial compliance test in State self-assessments to a 100 percent standard. Thus, we do not believe that including a specific method of measurement in the regulation is necessary. States may choose to address results of their procedures in their annual self-assessment reports.

17. *Comment:* Two commenters expressed concern regarding the open-ended nature of the proposal and requested the review process be limited to specific areas or issues. One of these commenters proposed that the review be limited to disputes surrounding the allocation and distribution of child support, and not applied to case management issues.

Response: We encourage IV-D agencies to strive to achieve efficiency and quality customer service in all program areas. The administrative complaint procedure will allow IV-D programs to demonstrate this commitment to improving customer service, by providing recipients of services with a process to express their concerns. We believe that IV-D recipients of services should have the ability to request a review of any aspect of their case, including case management issues. Thus, we have not adopted this specific suggestion to limit the scope of the regulation to disputes involving allocation and distribution of collections, although that is an appropriate area for review, if warranted. However, we have revised the language to require procedures "as defined by the State". This change is intended to allow States flexibility and discretion in structuring their own administrative complaint procedures.

18. *Comment:* Two commenters suggested that an additional paragraph should be added to § 303.35 to explicitly spell out what the rule does and does not require. This suggestion was made due to concern that the regulatory language allows the potential for extreme interpretations, controversy and legal action. In addition, one commenter suggested that, if the final regulations do require administrative reviews of prior

IV-D activity, that a time limit be included so that reviews will only go back for a specific period of time. Finally, one commenter expressed concern that the proposal does not indicate the specific recordkeeping requirements that would be imposed on States with respect to the review process.

Response: While we have not adopted these suggestions, they may be appropriate for State consideration in establishing procedures. As stated earlier, the intent of this regulation is to ensure that all State IV-D programs have some type of complaint process in place, not to dictate the specifics of the procedure. We believe it is preferable and supportable to allow States to establish their own procedures.

19. *Comment:* One commenter questioned whether allowing the custodial parent to review actions taken on their case would be in conflict with safeguarding provisions, stating that the IV-D agency is not allowed to release their work product.

Response: We do not believe that this provision would be in conflict with safeguarding provisions. The regulation does not allow a IV-D customer to review actions taken on his or her case. It requires the State to review the case at the request of the customer where there is evidence an action should have been taken and to notify the individual of the results of the review. This notification would not be a per se violation of the safeguarding requirements. Pursuant to section 454(26) of the Social Security Act, State IV-D programs are required "to have in effect safeguards, applicable to all confidential information handled by the State agency, that are designed to protect the privacy rights of the parties". States must design their administrative complaint procedures to ensure safeguarding requirements are met and that the information provided does not violate the privacy rights of one or both parties.

20. *Comment:* One commenter questioned how the administrative complaint process would be applied in interstate cases.

Response: Under current interstate case processing, applicants and recipients of IV-D services would express concerns to the IV-D agency in the State in which they applied or were referred for services. It would be the responsibility of that IV-D agency to determine whether the complaint involves its own actions or a responding State's actions in the case and to follow up by conducting its own review or contacting the other State's IV-D agency

for an administrative review, as appropriate.

21. *Comment:* One commenter indicated that the proposal is ill-timed as it coincides with the implementation of outcome measures, the incentive system and the expansion of penalty standards. The commenter suggested that this provision be delayed to allow OCSE to evaluate the impact of these other measures on program performance.

Response: We believe that the administrative complaint procedure is a central component and an appropriate element of the move toward measuring program results and performance-based incentives. As such, we do not believe that it is appropriate to delay these requirements for the administrative complaint procedures beyond the implementation of the incentive system and other outcome measures.

Comments to Section 305.1 Definitions

1. *Comment:* Two commenters recommended adding a sentence which further explains the meaning of "lack of jurisdiction." The added text would include the following qualifying statement: "Depending on applicable law concerning the subject matter jurisdiction in which the custodial parent or child resides, lack of jurisdiction cases may also include those cases in which the custodial parent or child resides in the civil jurisdictional boundaries of another country or federally recognized Indian Tribe." Another commenter stated the definition of lack of jurisdiction provided is not satisfactory and mentioned that subject matter jurisdiction issues begin with respect to the place of conception.

Response: We believe the sentence in § 305.1(a) is clear and adequate to explain the meaning of "lack of jurisdiction" for the purposes of Federal data reporting. Lack of jurisdiction refers to the practical effect of a State being unable to take action in a case due to lack of jurisdiction or other means to take establishment or collection action in the non-custodial parent's jurisdiction of residence. In cases where enforcement tools such as long arm jurisdiction can be used, there is no lack of jurisdiction.

2. *Comment:* A few commenters compared the proposed regulation with Federal data reporting instructions and expressed confusion over the definition of "collections received and distributed on behalf of title XIX (Medicaid) cases versus the proposed definition of title XIX cases." The commenters' understanding from Federal data reporting instructions is that "Medicaid

Only" collections and cases should be reported either as current or former assistance.

Response: The commenter's understanding is incorrect. Federal data reporting instructions for the OCSE-157 (AT-99-15) state that a "Medicaid Only case" is "a case where the child(ren) have been determined eligible for or are receiving Medicaid under title XIX of the Act, but who are not current or former recipients of aid under titles IV-A or IV-E of the Act. "Medicaid Only" cases are reported as never assistance cases." We remind States that "Medicaid Only" is defined and reported differently on the Federal financial reporting form, the OCSE-34A. The OCSE-34A will be the source for calculating a State's collections base for incentive purposes. "Medicaid Only" cases will be reported as current assistance cases on the OCSE-34A, unless the case was formerly on assistance and, therefore, will be reported as a former assistance case. States should refer to OCSE-34A instructions contained in Action Transmittal AT-00-02 and Dear Colleague letter DC-00-28. Under section 458A(b)(5)(C) of the Act, the "State Collections Base" double counts those collections in which the "support obligation * * * is required to be assigned to the State pursuant to Title IV-A (TANF), Title IV-E (Foster Care) or Title XIX (Medicaid) * * *" Incentive data taken from the OCSE-157 report uses total caseload and total collection numbers and are not broken into categories (i.e. current assistance, never assistance, and former assistance) for performance calculations. So, the fact that Medicaid only cases are reported differently on the OCSE-157 and OCSE-34A reports will not have an impact on incentives. However, since several commenters found this difference to be confusing, we will work with States to reconcile this difference in the future.

3. *Comment:* Several commenters requested a specific definition of "reliable data" in § 305.1(i). A few commenters offered definitions of "reliable data" that referred to Comptroller General standards (U.S. General Accounting Office) or specific statistical analysis methodologies, such as Analysis of Variance (ANOVA). Two commenters recommended that monitoring compliance with case closure regulations should be part of the data reliability audits. Another commenter recommended that data reliability audits should measure compliance with Federal reporting instructions.

Response: We have included a 95 percent standard for data reliability in response to comments to make the standard clearer than what was included in the proposed regulation. Our 95 percent standard is based on the unwritten, yet generally accepted 10 percent error rate used by the auditing community and based on our experience in FY 1999 data reliability audits conducted of State IV-D program data to date. We believe the definition of "reliable data" in § 305.1(i) as revised is adequate and preserves needed flexibility as State and Federal partners implement the new incentive, penalty, and audit system. Although no specific reference is made, General Accounting Office standards are included in the definition of "reliable data." We rejected the commenter's suggestion to use the analytical technique known as ANOVA because it is not suited for the comparison of results obtained from one sample of reported data.

While not included in the definition, case closure will be examined as part of the sample reviewed in the Data Reliability Audits. In addition, OCSE employs other methods to assure States are closing cases appropriately. Such methods may include reviewing reported data for large decreases in caseload from year to year and following up with a discretionary audit. State self-assessments are also an important management tool in assuring compliance with Federal requirements. Data Reliability Audits will measure the level of each State's compliance with Federal reporting instructions effectively providing a common standard by which all States will be compared. If a State does not comply with Federal reporting instructions, its data will not be determined to be complete and reliable.

4. *Comment:* One commenter suggested that the determination of data reliability and payment of incentives should not occur until a level playing field is established with statewide certified automated systems in place in all States.

Response: State and Federal partners began collaborating on standardized data definitions over five years ago. Consensus among partners was achieved on almost all details of the revised reporting system approximately two years ago through a State/Federal data definitions work group. The statute does not permit a delay in the assessment of data validity or in the implementation of the new incentive formula until automated systems are in place in all States. Data reliability can and will be assessed in States without certified statewide automated systems.

Incentives can also be paid to States with complete and reliable data that may not have a certified automated system. However, more frequent audits may be necessary for those States without an automated system. An audit would be warranted once a previously non-fully automated State places all cases on its automated system or when a State passes its FY1999 audit at or below the 95 percent level for any line item.

5. *Comment:* One commenter suggested that "parent" in the context of a IV-D case could include a legal custodian or guardian who may be obligated to pay support for a child, not just a mother, father, or putative father as described in section 301.1(a) of the proposed rule.

Response: While we agree that individuals other than parents may be obligated to pay support for a child in some cases and understand that several States have provisions that can hold step-parents liable for support, we have retained the term "parent" in § 305.1(a) for consistency with the majority of IV-D cases and with the OCSE-157 definition. States should, however, include IV-D cases where a legal custodian or guardian or step-parent becomes the obligor, and we will consider an expanded definition of the term in revisions to the OCSE-157.

6. *Comment:* Several commenters asked why Federal data reporting instructions for the OCSE-157 contained statements that were not included in the proposed rule. Others requested consistency with Federal reporting forms in a wide variety of definitions and instructions.

Response: We do not believe it is appropriate to include the same level of detail in the instructions in the rules. Federal reporting instructions (AT 99-15) do not conflict with statements in regulations, but rather elaborate on those requirements with greater specificity and examples. States must refer to the detailed instructions that accompany the various reporting forms rather than using the regulations as a guide to completing Federal data reporting forms.

7. *Comment:* One commenter suggested that there was not enough time for States to complete reprogramming of data reporting elements prior to Data Reliability Audits. The commenter requested that proposed definitions be deleted and instead a sentence could be added which refers to definitions contained in Federal reporting instructions. This way, any changes to the instructions are always covered by this section of the regulation.

Response: We believe there has been enough time for States to complete any reprogramming that is necessary. State reprogramming of data reporting elements should have begun with the issuance of form OCSE-157 instructions, AT-98-20 dated July 10, 1998. Limited modifications were made through AT-99-15. States should not be using the proposed rule or this final regulation as a guide to data reporting. States that do not report in a timely manner face a determination of incomplete data.

Almost all of these definitions are included in the statute and should not change frequently. It is appropriate to include definitions of key terms in regulations where they are subject to notice and comment rulemaking.

8. *Comment:* Several commenters expressed confusion about the words "received and distributed" in § 305.1(b) which defines current assistance collections and made various suggestions to provide clarification.

Response: This was intended to address collections made in one fiscal year but disbursed in the next fiscal year. For purposes of Federal data reporting, "distributed" means "disbursed." A State's incentive collections base for a fiscal year will only include collections "disbursed" in the reporting fiscal year for individuals receiving IV-D services.

9. *Comment:* One commenter recommended a phase-in of the data reliability requirement and consultation with States to determine an acceptable standard for fiscal year 2000.

Response: The statute requires that data be determined to be complete and reliable in order for a State to be eligible to receive incentive payments under the new provisions in section 458A of the Act, beginning with FY 2000 data. The requirement for complete and reliable data is being phased-in with the performance-based incentive system, *i.e.* the data upon which one-third and two-thirds of incentive funds will be paid are subject to this requirement in fiscal years 2000 and 2001, respectively. We have included a 95 percent standard for data reliability in these regulations beginning with respect to FY 2001 data. This standard is based on generally accepted standards within the auditing community and based on our experience in data reliability audits conducted to date.

10. *Comment:* One commenter suggested that the Secretary be given discretion to waive requirements in §§ 305.0 through 305.66 for fiscal year 2000. The commenter's rationale included apparent conflicts between the proposed rules and current data

reporting instructions and the uncertainty of projecting State incentives.

Response: There is no statutory authority for the Secretary to waive the many elements of the new incentive system implemented by the regulations. Moreover, the statute is clear enough to be implemented without final regulations. Federal data reporting instructions are not in conflict with the proposed rules, but rather contain more detail. States should follow reporting

instructions when reporting information for incentive calculations. Again, the phase-in period will limit State and Federal partners' uncertainty with the new performance-based incentive system.

11. *Comment:* One commenter asked for the specific lines from the OCSE-157 data report that match the elements needed to calculate the incentive collections base described in § 305.1(b)-(d).

Response: In the table below we have provided the specific line numbers from the reporting forms OCSE-157, OCSE-34A, and OCSE-396A which are used to calculate the five performance levels. This information will help States understand how OCSE will calculate State performance, highlight the importance of key data elements of State-reported data, and assist States in making projections of their own performance.

Incentive Measure Formulas (FY 2000 and Beyond)	
INCENTIVE MEASURE	FORM AND LINE NUMBERS
IV-D PEP	
Number of Children in the Caseload in the FY or as of the end of the FY Who Were Born Out-of-Wedlock with <u>Paternity Established or Acknowledged</u>	<u>OCSE-157 Line 6</u>
Number of Children in the Caseload as of the End of the FY Who were born	OCSE-157 Line 5 (of the preceding FY)
STATEWIDE PEP	
Number of Minor Children in the State Born Out-of-Wedlock with <u>Paternity Established or Acknowledged During the FY</u>	<u>OCSE-157 Line 9</u>
Number of Children in the State Born Out-of Wedlock During the Preceding FY	OCSE-157 Line 8 (of the preceding FY)
SUPPORT ORDER ESTABLISHMENT	
<u>Number of IV-D Cases with Support Orders</u>	<u>OCSE-157 Line 2</u>
Number of IV-D Cases	OCSE-157 Line 1
CURRENT COLLECTIONS	
<u>Amount Collected for Current Support in IV-D Cases</u>	<u>OCSE-157 Line 25</u>
Amount Owed for Current Support in IV-D Cases	OCSE-157 Line 24
ARREARAGE COLLECTIONS	
<u>Number of IV-D Cases Paying Toward Arrears</u>	<u>OCSE-157 Line 29</u>
Number of IV-D Cases With Arrears Due	OCSE-157 Line 28
COST EFFECTIVENESS	
<u>Total IV-D Dollars Collected</u>	<u>OCSE-34A Lines 8 + 5 + 13 of column (e)</u>
Total IV-D Dollars Expended	OCSE-396A Lines 9 columns (A) + (C) - 1(b) columns (A) + (C)
STATE COLLECTIONS BASE	
2(Current Assistance + Former Assistance Collections) + Never Assistance Collections	OCSE-34A: 2((Line 8 columns a+b+c) + (Line 5 columns a+b+c)) + Line 8 column d + Line 5 column d + Line 13 column e

Comments to Section 305.2 Performance Measures

1. *Comment:* One commenter recommended allowing States to exclude cases where it is impossible to establish paternity for children born out-of-wedlock in the preceding year. Examples of cases to exclude included: Mother's noncooperation, death of child or putative father before paternity

establishment, custodial parent closes case before paternity establishment, and inconclusive genetic testing. A second commenter asked if situations where paternity is contested for a child born within marriage should be included. A third commenter asked if a child can be excluded if good cause was in effect at any time during the fiscal year or must it be in effect at the end of the fiscal year.

Response: Some of the examples cited are very rare and are accounted for within the allowable tolerances in the performance standards. The performance standards for paternity establishment and other measures do not require 100% compliance in every case before an incentive can be earned or a penalty is avoided. State and Federal partners and Congress recognized that perfect performance was

not possible and decided to focus on effective or significantly improved performance.

Moreover, section 452(g)(2) of the Act requires that States exclude children in cases involving good cause. This would apply to cases where a good cause finding was in effect at any time during the year. OCSE has issued more detailed reporting instructions which instruct States to exclude children where there is noncooperation due to good cause or death of a parent as provided for under section 452(g) of the Act.

In addition, most State laws presume that a child born within a marriage is legitimate. These children could be determined to be born out-of-wedlock only if allowable under State law and then only if a court determined the presumed father could not have been the child's biological parent.

2. *Comment:* A number of commenters wanted Federal data reporting instructions and the proposed rule to be consistent. One commenter believed that "case count at a point in time" was not as specific as the wording of the numerator and denominator used in the support order measure itself.

Response: Federal reporting instructions are consistent with the measures as described in this regulation. However, regulations will not be as detailed as reporting instructions. The narrative description of the support order measure in the regulation is correct in identifying it as case count at a point-in-time (the end of this fiscal year). This measure counts cases with at least one support order.

3. *Comment:* One commenter said that the statewide paternity establishment percentage should include only children born in the reporting State and involved in an interstate case as it is inconsistent to include a child born out-of-wedlock in another State.

Response: Revised OCSE-157 reporting instructions issued in AT-99-15 explain that with respect to the statewide paternity percentage, States should report children who were born out-of-wedlock in the State since States get their data from their vital statistics agencies. This is also consistent with the instructions for counting the number of children with paternity established or acknowledged for the statewide PEP. The instructions require States to only include those children born in the State with paternity established or acknowledged.

4. *Comment:* One commenter said that "modification" must be defined in the explanation of the support order establishment measure. An example was cited from the commenter's State where a second case is created when a

subsequent child is born to the same parents until the new order can be consolidated with the earlier order.

Response: OCSE data reporting instructions (AT-99-15) explain that this measure is counting cases with orders, and modifications to an existing order should not be reported. However, if a second case is required to be established, it should be counted as a separate case until the two cases with orders are consolidated. When the consolidation occurs, the subsequent case should be subtracted from the count.

5. *Comment:* One commenter observed that § 305.2(a)(4) conflicts with AT-97-17 which requires States to first apply IRS Tax Offset collections to assigned arrears. The commenter believed that the performance criteria penalizes States that follow Federal distribution requirements. Another commenter believed that not counting Federal income tax refund offsets as an arrearage payment when no money goes to the family would lead to States directing efforts away from collecting arrears owed to the State. This would negatively impact the State's cost-effectiveness performance level.

Response: Section 458A(b)(6)(D) of the Act includes a specific requirement with respect to former assistance cases in which some arrearages are owed to the State and some arrearages are owed to the family. In such cases, States may only count cases in which some arrearage payments are distributed to the family. Congress added this provision in response to concerns that States would be able to count former assistance cases as cases paying arrearages for incentive purposes when the only action taken by the State was to submit the arrearages owed to the State for Federal income tax refund offset. Thus States would have no incentive to collect support owed to former assistance families.

In addition, we do not agree with the second commenter's statement that counting arrears payments this way would direct States away from collecting arrears. States have a strong inducement to collect arrears owed to the State in any circumstance because the State receives a direct financial benefit and because these collections help families stay off of TANF, thus increasing self-sufficiency.

6. *Comment:* One commenter believed that States should not be held to performance criteria for areas that have not been worked out. The commenter cited aspects of interstate cases, such as administrative enforcement and the absence of final regulations

implementing the Uniform Interstate Family Support Act.

Response: Interstate cases are a significant part of the child support caseload and the statute does not exclude these cases from the incentive formula's performance measures. Statutory provisions specifically provide for double counting of collections where one State collects support for another State, whether it is a traditional interstate case or an administrative enforcement is employed. Section 458A(c) of the Act requires support collected by one State at the request of another State to be treated as having been collected in full by each State.

7. *Comment:* One commenter said that "total IV-D dollars expended" should be defined better in the explanation of the cost-effectiveness performance measure and added that State program structure should be taken into account.

Response: "Total IV-D dollars expended" is a commonly used term in Federal financial reporting instructions. Instructions given to States for form OCSE-396A provide more detail on how this information should be reported by States. State and Federal partners that recommended the incentive formula to Congress believed all IV-D expenditures should be included in the cost-effectiveness performance measure. States do have the flexibility to structure their programs in many different ways. We encourage States to consider the impact of program structure, among many other factors, in assessing barriers to performance under the new incentive system.

8. *Comment:* One commenter believed § 305.2(a)(1), which describes the paternity establishment performance level, should read the count of children "may" (rather than shall) not include children in cases with a deceased parent or where good cause has been determined. The commenter stated that these cases are few and data reporting from automated systems is too costly and complicated.

Response: Section 452(g)(2) of the Act provides that the total number of children shall not include any child who is dependent by reason of the death of a parent unless paternity is established for such child or any child with respect to whom an applicant or recipient is found to have good cause for refusing to cooperate. Accordingly, these children shall not be included in the count.

9. *Comment:* One commenter recommended that special provision be made for States like California, New York, Florida, and Texas, who have a higher number of immigrants.

Response: The statute governing incentives is very specific and does not allow for any such special provisions. We assume the commenter is referring to cases where one parent resides in a foreign country. While we agree that some cases involving immigrants may present greater challenges to child support enforcement programs, there are often mechanisms for working these cases such as agreements between the State and the foreign country. When there is no jurisdiction to work the case and no mechanism to facilitate government-to-government cooperation, these cases will not be included in the incentive calculation.

It should also be noted that the Child Support Performance and Incentive Act of 1998 requires the Secretary to conduct a study “* * * that identifies any demographic or economic variables that account for differences in the performance levels achieved by the States with respect to the performance measures...” and make recommendations for changes “* * * to the system as may be necessary to ensure that the relative performance of States is measured from a baseline that takes account of any such variables.” This report due to the Congress October 1, 2000, will provide useful information to the States and Federal government on the affect such variables have on State performance.

10. *Comment:* One commenter asked a question about counting voluntary collections in the current collections performance level. The commenter stated that there is no amount “owed” in a voluntary payment and therefore it cannot be included in the denominator.

Response: Section 305.2 requires voluntary payments to be included in both the numerator and denominator of the current collections performance level. This is the only way the State can take credit for the voluntary payment as a “collection.” In these circumstances, we believe it is reasonable to consider the amount paid to be the amount “owed” until a support order can be established.

11. *Comment:* A few commenters recommended excluding “minor” from the numerator of the statewide paternity establishment percentage because a case may begin when the child is a minor and be resolved after the age of majority in the same fiscal year.

Response: The numerator of the statewide paternity establishment percentage is taken directly from section 452(g) of the Act and, therefore, the word “minor” may not be excluded. Federal data reporting instructions (AT-99-15) state that emancipated children should not be included in the count of

children and that States should only include those children who are under 18. However, instructions do allow States to count children who have reached their 18th birthday in the fiscal year being reported. This standardized definition of a minor child was added to address States’ desire for a “level playing field” regarding the paternity establishment percentage—that no particular State have an unfair advantage regarding the PEP because of the way that State defines emancipation.

12. *Comment:* One commenter suggested the inclusion of an additional optional performance measure for the current collections performance level. The measure would presumably compare the number of cases paying on current support to the number of cases with current support due.

Response: There is no statutory authority for including a second optional measure for the current collections performance level for incentive payments. In addition, State and Federal partners did not recommend a case-based measure on current support because States treat these collections similarly, unlike arrearage collections which are dealt with in significantly different ways by individual States. However, nothing prevents a State from tracking performance in this way for its own program monitoring purposes. For penalty purposes, we believe States should be measured using the same measure that is used for incentive payments.

Comments to § 305.31 Amount of incentive payment

1. *Comment:* One commenter recommended rewording § 305.31(e) for clarity to read: “A State’s maximum incentive base amount for a State for a fiscal year is zero if the fiscal year data submitted by the State to calculate a performance level fails to meet data reliability items as determined by a Federal audit performed under § 305.60(1) of this part.”

Response: Paragraph (e) tracks the from statutory language in section 458A(b)(5)(B) and we believe it is clear as written.

2. *Comment:* Several commenters inquired about how HHS will handle downward adjustments in incentive payments for States that overestimated their quarterly claims or whose performance data was found to be incomplete or unreliable. Commenters asked if the funds would go to other States, a pool for future years, or are lost.

Response: In the case of States that overestimated quarterly estimated

claims for incentive payments, there will be a final adjustment of IV-D grant awards approximately nine months after the end of the fiscal year. Final adjustments can be either up or down depending upon the State’s original estimated quarterly claims, calculation of the traditional cost-effectiveness incentive formula and the proportional distribution of incentive funds to all States based on performance. This mirrors the traditional process in which incentive payments have been made to States. During the phase-in period, this adjustment will be based upon calculation of the traditional cost-effectiveness incentive and calculation of the new performance-based incentives. During fiscal year 2000, only one-third of the incentive pool or \$139 million will be available for payment to the States based on the new incentive, while two thirds of a State’s incentive will be earned based on the traditional incentive system. Funds from downward adjustments made under the new incentive provisions will go to other States. Funds from downward adjustments attributable to the existing incentive system will be returned to the U.S. Treasury. Because of the uncertainty involved with amounts that individual States will earn under the new incentive system, we encourage States to be conservative in their estimates of incentives for the phase-in years of the new system.

In the case where a State is determined to have incomplete or unreliable data, and is thus ineligible for incentives under the new incentive system, those funds will be redistributed to other States based on their performance for the same fiscal year. We remind commenters that completeness and reliability of a State’s performance data will be determined on a measure by measure basis. The determination is not “all or nothing”—incentive funds are calculated based on the State’s scores for each of the five performance measures. Accordingly, a State which has incomplete or unreliable data with respect to one (or more) performance measures may still qualify for incentive payments based on its performance levels for the remaining measures.

3. *Comment:* Several commenters stated that the calculation of the incentive formula is too complicated, preventing States from estimating incentives and delaying payment of incentives until all States report data and final calculations are made. One commenter recommended a revised process that allows State and Federal governments to make reasonable decisions about the amount of incentive

payments. Another commenter said that requiring States to estimate their own incentives is contrary to legislation which requires the Secretary to estimate the amount of State incentives. A few commenters asked for a methodology or guidance to estimate incentives, while others recommended speedy estimates or taking into account the phase-in period.

Response: The incentive calculation is explicitly required by statute and therefore, we are unable to modify it. We are aware that it presents challenges to State and Federal planning and implementation. There is a significant amount of uncertainty as we move from the traditional incentive system to one based on performance. As State and Federal partners gain more experience with data reporting and performance under the new system, the ability to predict performance should improve.

We are committed to monitoring the implementation of the new incentive payment process and consulting with States. We will recommend improvements to Congress if elements of the formula prove to be unworkable or contrary to the intent of improving the program's performance.

Federal staff have traditionally made estimated incentive payments based on State estimates of future incentive earnings. The program is forward funded with final adjustments to funding made later as actual data is reported. This process will not change. Federal staff will perform an analysis to determine if State estimates appear to be significantly higher or lower than likely actual incentives and recommend adjustments. We believe this comports with the statutory requirement that the Secretary make estimated payments based on the best information available. In addition, the phase-in period limits the amount of uncertainty with regard to estimating incentives for fiscal years 2000 and 2001.

4. *Comment:* One commenter observed that States should be able to identify whether a case formerly received public assistance by use of an indicator present in State files and the Federal Case Registry. Computer matching of data files could be used to share this information with other States in interstate cases so that collections in former assistance cases can be given double credit in the calculation of the State incentive base.

Response: The commenter correctly identifies that it will be to each State's advantage to identify which cases formerly received public assistance. We encourage States to share this information in interstate cases. We recognize that each State's ability to

identify these cases will vary depending upon historical records and automation. While States may not have complete information on older cases, they will benefit from developing a procedure for recording former assistance status on cases in FY 2000 and beyond.

The Federal Case Registry does not currently include a data element which would indicate whether a case formerly received assistance. In the future, such a data element could be considered for discussion by State and Federal partners.

5. *Comment:* Several commenters expressed concern that required Data Reliability Audits would not be completed in order for FY 2000 incentives to be calculated and paid.

Response: Data Reliability Audits for FY 2000 incentives will not begin until FY 2000 data is available from States. OCSE is committed to providing adequate resources for Federal auditors to complete the necessary work to calculate each year's incentive payments. Data Reliability Audits rely on the submission of State-reported data and cooperation of the States. Because of the time it takes to conduct audits in every State, it is imperative that data be submitted on a timely basis. That is why we are imposing a deadline of December 31st for the reporting of final adjusted data for a fiscal year. Audits will be conducted based on the data submitted by States up until December 31st. If these data are determined to be incomplete or unreliable, the State will be subject to a loss of incentive funds for the prior fiscal year. In addition, the results of the fiscal year 1999 audit will be important in determining the level of audit necessary for a State for fiscal year 2000. For those States meeting a high level of reliability in 1999, the audit will not have to be as exhaustive as it will for those States displaying a low level of reliability in 1999, or for those States that have made major changes in their systems or other data related processes. States may request a data reliability audit during FY 2000 if they have the ability to produce an "ad hoc" report using FY 2000 data which OCSE can review.

6. *Comment:* One commenter wrote that using 1998 as a base year for program expenditures will unfairly penalize States that paid for automated systems during this timeframe.

Response: That is why we have included an alternative base period that States may elect to use. States have the option of using the average amount for fiscal years 1996, 1997, and 1998 for determining a State's base year for reinvestment of incentives. Employing a three-year average would decrease the

effect of large non-recurring expenditures such as automated systems.

7. *Comment:* One commenter asked how the statutorily-capped amounts of the incentive pool for FY 2000 through FY 2008 were determined. The same commenter inquired if two-thirds of the old incentive formula equals or exceeds the FY 2000 pool of \$422 million for all States, will additional money be made available for States to earn the one-third new incentive?

Response: The original statutory requirement for development of a new performance-based incentive formula required the new formula to be cost neutral, meaning not costing more than projections of incentives payments under the old formula. Congress enacted the capped incentive pool amounts contained in section 458A(b)(2) of the Act based on budget estimates for these years.

During the phase-in period of FY 2000–2001, the old and new incentive formulas are in operation concurrently. Thus, for FY 2000 the old formula which is uncapped would be calculated as usual and two-thirds of that amount would be actually paid to the States based on this formula. One-third, or \$139 million, of the FY 2000 incentive pool of \$422 million would be paid for States' performance on the new formula. Because the old formula is affected by declining TANF collections, which also caps incentives paid for non-TANF collections under the old incentive formula, and the two-thirds phase-in, we do not expect that States will earn more than \$422 million.

8. *Comment:* One commenter believed that § 305.32(c) implied that both States may count an interstate administrative enforcement collection in its collections base in addition to traditional interstate collections.

Response: Statutory provisions specifically allow for double counting of collections where one State collects support for another State, whether it is a traditional interstate case or administrative enforcement is employed. Section 458A(c) of the Act provides that support collected by one State at the request of another State shall be treated as having been collected in full by each State. Collections received via administrative enforcement in interstate cases can only be reported by both the responding and initiating States if they meet the requirement of section 458A(c). If, for example, State A uses administrative enforcement to collect support by itself, such as through interstate wage withholding where State A sends a wage withholding request directly to an employer in State B, only

State A would qualify for reporting the collection. Similarly, if State B provides information or other assistance (and not actual collection) to State A in response to a request, it would not be able to report the collection. We will use State-reported data to calculate all components of the incentive formula including the collections base.

9. *Comment:* One commenter asked how the phase-in provisions would impact the payment of incentives under §§ 305.31 and § 305.34 and reinvestment of incentives under section § 305.35.

Response: During fiscal years 2000 and 2001, the old and new incentive formulas are in operation concurrently. Therefore, for fiscal year 2000, States will be able to earn two-thirds of what they earn under the traditional cost-effectiveness formula, which is uncapped. One-third of the \$422 million fiscal year 2000 incentive pool or \$139 million will be available to all States to be shared under the performance-based incentive formula. For fiscal year 2001, States will be able to earn one-third of what they earn under the traditional cost-effectiveness formula, which is uncapped. Two-thirds of the \$429 million fiscal year 2001 incentive pool or \$286 million will be available to all States to be shared under the performance-based incentive formula.

The incentive payment process required by § 305.34 remains unchanged during the phase-in period except that we must factor in the performance of all States for the partial (1/3rd or 2/3rd) calculation of the performance-based incentive payment. Complete and reliable State data are required for payment of incentives on the performance-based formula.

The reinvestment requirement described in § 305.35 is applicable to one-third and two-thirds portions of the incentives a State may receive under the new formula for fiscal years 2000 and 2001 respectively.

10. *Comment:* One commenter pointed out an error in the example given at Table B to Paragraph (j).

Response: The commenter was correct in that there was an error in the numbers for two of the fictional States. We corrected that error in the example which appears earlier in this preamble and are eliminating the example at § 305.33 (j) from the final rule, since it was there for illustrative purposes only.

Comments to Section 305.35 Reinvestment

1. *Comment:* Several commenters suggested that the requirement to reinvest incentive funds in the Title IV-D program be phased-in over the same three year period as the new incentive

structure. One commenter stated that there is no need for Federal intrusion into this area. Another commenter suggested that the reinvestment requirement be tabled until the new incentive system is fully implemented and data can be validated. One commenter said the rule was unclear regarding the starting date of the reinvestment requirement.

Response: Section 458A(f) of the Social Security Act provides for a phase-in of the requirement for States to reinvest incentive payments which matches the implementation of the new incentive payment system. Only incentive payments based on the new system must be reinvested. Accordingly, one-third of FY 2000 incentives, two-thirds of FY 2001 incentives, and all of FY 2002 incentives and beyond must be reinvested in the IV-D program. There is no statutory authority to delay implementation of the reinvestment requirement.

In the past, there were no requirements on use of incentive funds except that they be shared with political subdivisions that help operate the program. Over the years, the fact that IV-D incentive funds could be used to support State or local programs other than child support drew much attention. The reinvestment requirement had its roots in the consensus of the State and Federal workgroup on incentives. The Congress clearly expressed its belief that financial rewards earned by the IV-D program should be reinvested in the IV-D program by enacting a reinvestment requirement. The requirement to reinvest incentive funds should add critical resources to State efforts to improve the performance of child support enforcement programs.

2. *Comment:* One commenter suggested a third alternative to calculating the base amount of a State's IV-D program investment: the denominator of the previous year's cost effectiveness ratio (total IV-D dollars expended) minus the previous year's incentives earned, only if the cost effectiveness ratio was at least \$3.00 and at least two other performance measures remained constant or increased over the previous year.

Response: We have not implemented the commenter's suggested alternative because this alternative method would reward States with average cost-effectiveness and static or increased performance on any two of the other four measures. Its effect would be to lower the base amount of State IV-D expenditures. This method would also be more complicated and might not be applicable to a few States because the

proposed performance criteria would not be met. Our intention was to provide a simple method of calculation. We do not believe it is appropriate or consistent with the statutory intent to set criteria based on performance that would allow some States to employ a favorable base calculation method while others could not do so.

3. *Comment:* One commenter suggested a fourth alternative to calculating the base amount of a State's IV-D program investment. A base cost per case formula was suggested to allow greater flexibility for all States in years of substantially declining or increasing caseloads. The formula was not described further.

Response: We have not implemented the commenter's suggested alternative. Under this alternative, substantial increases or decreases in caseload from year to year would significantly affect a State's required investment. States could have difficulty ensuring that the appropriate amount was reinvested. The commenter's alternative method could also have required States to invest more than the value of their incentive payments. Finally, we are not convinced that a base cost per case is something that States should be encouraged to maintain.

4. *Comment:* One commenter suggested clarifying whether the OCSE Commissioner can approve expenditures of incentives outside the IV-D program.

Response: OCSE will issue instructions after the publication of the final regulation which provide the details of the spending approval process.

5. *Comment:* Several commenters stated that the outside examples provided in § 305.35(e) are unclear and should be deleted.

Response: We agree that the examples caused some confusion and therefore have deleted the examples at § 305.35(e) and redesignated § 305.35(f) as § 305.35(e). We have revised paragraph (d) to clarify when incentive amounts may be subtracted from FY 1998 expenditures.

6. *Comment:* A few commenters suggested that the base amount should exclude extraordinary or other one-time non-recurring (e.g., expenses incurred for federal automated system certification) because it would work against States' cost effectiveness.

Response: The exclusion of long term investments was considered and rejected numerous times by State and Federal partners on a number of work groups. It is also not authorized by the statute. Therefore, we have not implemented this suggestion in the final

regulation. We appreciate the difficulty created by capital or nonrecurring expenditures like automated system investments. The rule provides for an alternative base year calculation that would use a three-year average calculation in order to avoid inflated spending in any one year for nonrecurring expenditures. We believe that the calculation of a State's base amount for reinvestment purposes should be consistent with the longstanding method of measuring State program's cost-effectiveness which uses total IV-D expenditures. Total costs are included in the denominator of the cost-effectiveness measure for incentive purposes. Certain costs in addition to systems costs, such as staff training and paternity establishment, may not have immediate payoff in terms of collections. States that wish to minimize the problem of nonrecurring expenditures in 1998 should elect to use the three-year average base amount calculation provided in the final rule.

7. *Comment:* Two commenters believed the baseline of historic State expenditures should include all State expenditures, including incentive payments. The commenters also argued that the proposed rule ignored the reality that State money is fungible, or easily mixed with other funds.

Response: The inclusion of State incentive payments as expenditures would require States that have historically used incentive funds to support the IV-D program to increase their spending by the amount of any new incentive funds that they received. The reinvestment requirement is not intended to force States to extraordinarily increase program funding. However, we recognize that once Federal funds are transmitted to a State, they become mixed with other funds and can not be identified as "IV-D incentive funds." A State will be allowed to subtract the incentive funds received only to the extent that the State can document that they were reinvested in the IV-D program.

8. *Comment:* One commenter asked when the instructions on what non-IV-D activities would be acceptable for the use of incentive funds would be issued? The commenter also asked if such identified activities would be eligible for regular Federal financial participation at 66%.

Response: After publication of the final regulations, OCSE will issue instructions on how States may request to spend incentive funds on activities not currently eligible for funding under the IV-D program, but which would benefit the IV-D program. However, while the statute allows incentives to be

used for expenditures outside the IV-D program, these instructions will offer suggestions for acceptable uses of incentive funds that will not be all inclusive and will require documentation of proposed spending. There is no statutory authority to expand eligibility for Federal IV-D funding of ineligible activities.

9. *Comment:* One commenter asked how will the Federal government know if individual counties have complied with the reinvestment requirement and who is responsible for ensuring compliance. Another commenter stated that the proposed rule did not address what will occur when a State is deemed to be supplanting State funds previously used to fund IV-D functions.

Response: States are responsible for ensuring that all components of their IV-D programs comply with all Federal requirements, including local or county IV-D programs, vendors, or other entities that perform IV-D services under contract or cooperative agreement. Federal auditors' and central and regional office staff will have a role in monitoring State compliance with the reinvestment requirement. Potential Federal actions include financial audits which could result in disallowances of incentive amounts equal to the amount of funds supplanted.

10. *Comment:* One commenter asked what happens if the State's level of performance and resulting incentives decline in future years after the base amount is determined?

Response: If the amount of a State's incentives declines in future years, it would not affect its base amount. Whatever amount of incentives it received in future years would still have to be spent in addition to the base amount. If this scenario occurs, overall spending (base plus incentives) would necessarily decline if the State decided not to otherwise increase its spending on the program. We remind States that the base amount plus incentives only establishes a minimum level of spending and can always be augmented by State increases in spending on its IV-D program. Additional State spending may address performance problems which have resulted in declining incentive amounts. If a State earns less in incentives, fewer incentive dollars would have to be reinvested the following years.

11. *Comment:* One commenter stated that the proposed rule would preclude a State from making cost reductions since the base amount would need to be spent each year. Another commenter expressed concern about the use of historical data to determine the base amount.

Response: As noted in the proposed rule, we recognized that a fixed base year could potentially penalize States that reduce costs as a result of program improvement or cuts in government spending. On the other hand, we also recognized that a fixed base year would not reflect inflation or other increases in the cost of personnel or services. Thus, any negative effects would be lessened over time. We invited suggestions for alternative methods and did not receive any that we believed were better. The trend established by 25 years of the child support program indicates that most States have increased expenditures from year to year. The trend in increased spending has reflected the statutory expansion of the program and growth in the need for services. Historical data is the most recent available data upon which to calculate a base amount. We believe that the use of historical data was the best method available to us for setting this procedure.

12. *Comment:* One commenter was concerned that the methods proposed to calculate the base amount will mandate that States will artificially inflate their expenditures in order to demonstrate that they satisfied the reinvestment requirement.

Response: State reporting will be audited for reliability in addition to being monitored by Federal regional and central office staff. States that report and claim expenditures that are higher than actual expenditures will be subject to disallowances. Additionally, they will be subject to a loss of incentive payments and penalties for unreliable data, since program expenditures are used to compute incentive payments. Finally, artificial inflation of expenditures would be counterproductive in that would harm the State's cost-effectiveness performance level, thus lowering the amount of incentive funds to which the State would be entitled.

Comments to § 305.40 Penalty performance measures and levels

1. *Comment:* Several commenters stated that performance penalties for order establishment and current support collections should be eliminated from the proposed rule. The commenters identified that the Social Security Act only expressly requires a performance penalty for failure to meet the paternity establishment percentages. One of the commenters recommending elimination characterized the penalties as "discretionary."

Response: Section 409(a)(8) states that reductions of up to five percent would be taken against a State's TANF grant for

the failure to meet other performance standards as may be specified by the Secretary. After developing a national strategic plan, incentive measures, and a new data reporting system, partners met to consider development of a consistent penalty system. Careful consideration was given to the importance of applying penalties to the measures on order establishment and current support collections as indicated by the extra weight given these measures in calculating incentive payments. These measures show a State's success in getting critical regular support payments to families. Substantial consensus that these penalties should be adopted was achieved among all States, whether as a member of the work group that reported its recommendations to the OCSE Commissioner, or consulted through representatives.

2. *Comment:* Several commenters stated that performance penalties for order establishment and current support collection should be delayed. Some of the reasons included current implementation of new data reliability audit process and the ability of all States and territories to report performance data completely, accurately and in accordance with due dates. Since the data reporting ability of States has not been audited, commenters argued, how can penalties be imposed?

Response: Data reporting on the new form is improving, since technical assistance on the new form and the new audit process has been given to States. However, an automatic corrective action period of one year builds-in delay which allows States to identify and to correct either reporting or performance problems prior to being assessed a financial penalty. States should be diligent in continuously monitoring their own performance and data reliability.

3. *Comment:* A few commenters suggested that the performance penalties should be delayed because it is a better management practice to allow the incentives to produce the desired results first and implement negative penalties later if poor performance continues.

Response: State and Federal partners considered the implementation of performance penalties and arrived at a consensus decision to go forward with a performance penalty system required by statute. Performance penalties were recommended to be implemented in FY 2001. In addition, any performance penalty will be delayed an additional (FY 2002) year for corrective action and should performance improve during that year sufficiently to avoid a penalty,

no penalty will be assessed. Penalties can also be avoided at the lower levels if a significant level of improvement is achieved over the previous year. The statutory paternity penalty and requirement to "meet other performance standards specified by the Secretary" have been part of the Social Security Act since 1997. Since the performance measures are the same, further delay in implementing penalties while more experience with the incentives is gained would not be appropriate.

4. *Comment:* One commenter stated that the incentive and penalty structure is flawed because a State could receive an incentive and a penalty "on the same measure at the same time."

Response: This statement is potentially true for performance only in paternity establishment. An incentive could be earned for the high performance level while the State's lack of improvement at a significant level would cause a penalty to be incurred. Congress was aware of this possible interaction when the incentive structure was built upon the preexisting penalty structure. The corrective action period of a year not only delays the penalty for one year but also allows the State to avoid the penalty by improved performance. This incentive-penalty interaction is unique to the paternity establishment measure and does not occur with order establishment and current support collections. Under performance standards for order establishment and current support collections, high or significantly improved performance produces an incentive, poor performance triggers a penalty, and intermediate performance warrants neither an incentive nor a penalty.

5. *Comment:* Several commenters expressed concern that a State could be penalized for interstate cases where the State relies on the actions of another State and recommended that States should have the option to exclude these cases.

Response: There is no statutory basis to exclude these cases. Interstate cases represent approximately one-quarter to one-third of the national child support caseload. This would substantially decrease the number of cases for which a State was rewarded to achieve results. Removal from the incentives calculation might actually lead to encouraging neglect of these cases. Indeed, while interstate cases are among the most challenging cases to work, the Uniform Interstate Family Support Act (UIFSA) provides a workable mechanism for States to cooperate in establishing orders and enforcing cases. State and Federal partners continually strive to

improve coordination among States on interstate caseloads through training, technical assistance, standardized procedures and dialogue. The statute and data reporting instructions only allow for the exclusion of cases where there is no jurisdiction (international cases and cases involving tribal sovereignty) and no mechanism such as cooperative agreements to work the case.

6. *Comment:* One commenter stated that the penalty structure did not capture important elements of the child support enforcement program and would be better focused on different areas of performance from the incentive measures.

Response: Both State and Federal partners and Congress have clearly expressed that the areas of paternity establishment, order establishment, current support collections are the most critical performance areas of the child support program. These performance measures have been enacted in law and are given greater weight in the incentive calculation. We believe these performance areas best express the results or outcomes desired by the program and the other program requirements while important, may often reflect measures of process. We also believe that incentive and penalty structures should be as consistent as possible. Having a few critical measures sanctioning poor performance allows States to focus resources, whereas scattering penalties among other additional performance areas may diminish the results of the program by spreading resources too thinly. This is also not the only means of assessing State performance. State self assessment, Federal regional office reviews and other Federal audits will contribute to determining whether States are operating programs that meet all IV-D requirements.

7. *Comment:* One commenter suggested that assessing penalties against a State's title IV-A payments was unfair to the Temporary Assistance to Needy Families (TANF) program. This might lead to tension between the child support and temporary assistance programs and penalties taken against either program would reduce resources needed to achieve desired results.

Response: Section 409(a)(8) of the Act clearly requires that penalties for lack of compliance, incomplete or unreliable data reporting or poor performance in the child support program are to be taken against the State's title IV-A payment. Congress has traditionally linked these two programs in many areas and has continued this statutory linkage with performance and other

penalties in the child support program. The consequences of a penalty reducing financial resources and affecting services of a program are real. This reality strengthens the deterrent effect on States to avoid the penalty initially and to improve performance the year following a penalty to avoid repetition of negative consequences.

8. *Comment:* One commenter believed that the order establishment penalty structure is not equitable to States that perform below the fifty percent threshold needed for an incentive. State A improves its performance by five percentage points from one year to the next and receives an incentive. State B performs at higher level than State A, but below the fifty percent threshold and improves by three percentage points over the previous year, but is not eligible for an incentive. A similar example is provided using the current support collections performance levels.

Response: Since the commenter's example actually refers to the bases for receiving or not receiving an incentive, we address our response accordingly. The performance levels for order establishment and current support collections were developed by State and Federal partners after reviewing historical performance data on the child support program. The group established levels that would reward a State for significant improvement from year to year in addition to rewarding high performance above a certain threshold. These performance levels received a nearly unanimous consensus from the States and Congress subsequently enacted these levels without change. The commenter's example is correct. States that achieve a significant improvement of five percentage points but perform at a lower level than other States with no significant improvement will receive a portion of the incentive payment for that measure. The structure is designed to reward significant improvement at lower levels of performance on order establishment and current support collections.

9. *Comment:* One commenter identified that the proposed regulation § 305.61(c) is ambiguous about when and how different levels of penalties will be imposed. The commenter suggested that language should be added that OCSE may impose the higher penalty in situations with multiple penalties, willful or egregious violations, and repeated penalties or violations. In addition, the commenter stated that penalties should be imposed for failing a financial management audit.

Response: Section 305.61 states that the penalty percentage will increase from one to two percent for the first

finding, two to three percent for the second finding, and three to five percent for a third or subsequent finding. We believe setting such criteria may confuse States about when a higher penalty might be imposed. The regulation clearly imposes higher penalties for repeated failures from year to year. We believe it is important to preserve discretion of the Secretary in taking penalties and do not want to restrict decisionmaking where each circumstance is considered individually. Section 409 of the Act also limits total penalties assessed by Child Support or TANF against the TANF grant to 25%. We are cognizant that multiple penalties and higher penalties raise awareness of the interaction with the TANF program.

Section 409(a)(8) of the Act also imposes a penalty for failure to submit complete and reliable data. Collections and expenditure data will be reviewed by Federal auditors to determine its completeness and reliability. Section 409(a)(8) does not provide for a penalty for failing a financial management audit. However, financial management problems uncovered by Federal staff can result in the disallowance of claimed expenditures and reductions in grants to States.

Comments to § 305.60 Types and scope of Federal audits

1. *Comment:* Because of concern about the definition of reliable data, the Yellow Book standards should be included in the final rule, or at least referenced.

Response: The final rule refers to standards of the Comptroller General and to the GAO Standards, as promulgated in "Government Auditing Standards" which is the "Yellow Book".

2. *Comment:* States are currently given a very long time in which to correct data problems. Meanwhile, OCSE is using unreliable data to calculate incentives and penalties. Rather than performing a full audit, in FY 2000, OCSE should conduct a baseline data quality audit of all States and provide help to those with unreliable data.

Response: The OCSE Division of Audit is conducting baseline audits of FY 1999 data and informing States of any deficiencies found during the audits. This process provides States the opportunity for implementing necessary corrective actions before reporting FY 2000 data and the initiation of payments under the new incentive system. OCSE is available to provide technical assistance to States.

3. *Comment:* At minimum, § 305.60(c)(2)(i) should indicate that

OCSE will audit a program when two or more State self-assessments indicate poor performance. The regulation should also give OCSE the power to conduct an audit on the basis of one self-assessment if that self-assessment indicates serious deficiencies.

Response: The wording of § 305.60(c)(2)(i) and the statute allow the Secretary flexibility to determine when to carry out additional types of audits. We do not believe it would be helpful to mandate the timing of any audits and believe it is appropriate to make the determination based on all the circumstances involved.

4. *Comment:* While the proposed regulations do not address the critical issue of proper distribution, it may be that OCSE intends disbursement to include distribution, but if it does, it should say so.

Response: Distribution in accordance with the Federal statute and regulations is not a part of the new incentive and penalty system. However, proper distribution will still be reviewed under automated data processing system certification reviews for PRWORA and as part of substantial compliance audits. For purposes of reporting on OCSE forms, distribution means disbursement.

5. *Comment:* A two-year timeframe for an audit based on self-assessment results with the possibility of a penalty, is counterproductive. The commenter suggests a graduated approach that includes consultation, technical assistance, and an advisory audit with penalties only occurring after 4 or 5 years of insufficient compliance.

Response: These regulations merely indicate that an audit could be initiated based on two or more poor self assessments. Substantial compliance audits are discretionary and will be used to monitor instances of severe deficiencies in State program case processing.

6. *Comment:* The proposed rule allows States to receive incentives under certain circumstances based on an increase in performance from the previous year. The rules do not address the situation which may occur when the previous year's data was determined incomplete or unreliable. This should be clarified.

Response: If a State fails to report complete and reliable data for any one of the incentive measures, the State will not receive an incentive for the performance measure for which the data are determined to be incomplete or unreliable. If the State is able to correct the problem and substitutes corrected data by the time data are required to be submitted for the next year's incentive payment determination, it will be able

to earn incentives for the next year on improvement measures based on the corrected data. If the data problem is not corrected, a State will not be able to earn incentives based on improved performance.

7. *Comment:* It should be clear that States must pass the audit before any incentives are paid and that periodic audits begin only after the initial audit. The regulation should also clarify OCSE authority to conduct audits more frequently than every 3 years. It should include a catchall provision for audits whenever there is reason to question a State's data reliability. The broad scope of audits should be made clear, including that auditors are not limited to a review of material provided by the State.

Response: We believe the statutory and regulatory language is clear on all of these points. Section 305.60(d) states that "OCSE will conduct audits of the State's IV-D program through inspection, inquiries, observation, and confirmation * * *" as well as a review of State provided material. Before incentives may be paid for any fiscal year, the Secretary must determine, based on an audit, that the State's data are complete and reliable. Thus there is no need to add any language concerning audits of data reliability.

Federal audits have proven to be a valuable tool to focus States on necessary improvements. The integrity of the new incentives and penalty process depends on reliable, complete data and on the Federal auditors' role in assessing whether States produce such data.

8. *Comment:* An audit should review the use of funds to determine if incentive payments are being used to supplement rather than supplant other funds.

Response: Administrative cost audits will be performed and will determine if program funds are expended in accordance with Federal regulations.

9. *Comment:* Section 305.60(c)(2) should provide that "OCSE may initiate audits to determine substantial compliance, or for such other purposes as OCSE may find necessary, whenever it has credible evidence of a failure to comply with one or more of the requirements of the IV-D program."

Response: We believe the wording of § 305.60(c)(2) as currently drafted allows OCSE maximum flexibility to carry out our mandated and authorized duties.

10. *Comment:* Does the term substantial compliance apply to each individual requirement identified? If so, does this mean that a State can be

penalized based on an audit that just reviewed one specific area (e.g., case closure) that the State failed?

Response: The term substantial compliance does apply to each individual requirement identified for audit. Yes, a State is subject to a penalty based on a failure to meet requirements in a specific area if corrective measures are not taken during the specified corrective action period.

11. *Comment:* The regulation should provide that when a State fails data reliability requirements, it will be audited annually until it passes. Data reliability should be checked annually for States without a certified system or when there are changes to a system. An audit of data quality should include an audit for compliance with case closure regulations.

Response: OCSE will continue its practice of performing annual audits of any State that it determines does not achieve substantial compliance with a program requirement or requirements or fails data reliability requirements until such time that the State able to achieve substantial compliance or the data reliability requirements are met. Also, a State may make significant changes to the system used to accumulate and report their performance indicator data. These changes will be reviewed by the auditors each year to the extent necessary to determine the completeness and reliability of the performance indicator data. While case closure is not one of the performance measures, it is evaluated during data reliability audits.

12. *Comment:* The rule is unclear whether an error in a case applies to the "life of the case" or is restricted to a given fiscal year. We recommend that the error be restricted to a given fiscal year.

Response: An error in a case is restricted to a given fiscal year.

13. *Comment:* We are concerned about language in proposed § 305.60 describing the types and scope of audits. For example, subsection (b)(2) states that audits would be conducted to determine, "whether collections and disbursements of support payments are carried out correctly and are fully accounted for." With the extremely complicated arrearage distribution rules that became law with PRWORA, we are concerned that a strict interpretation of this language could make States vulnerable to penalties. This language should be rewritten to recognize the complexity of the distribution system and reduce the vulnerability of States.

Response: States are required to meet the distribution rules as enacted in PRWORA. OCSE auditors are

knowledgeable of the extremely complicated statutory arrearage distribution rules and this is reflected in the audit instructions.

14. *Comment:* Section 305.63 would allow penalties to be imposed on States based on targeted audits of specific IV-D requirements. We are concerned that targeted audits would not measure "substantial compliance" and would increase the financial exposure of States.

Response: Targeted audits will measure substantial compliance with the area audited. A penalty could be imposed if a State is found not to be in substantial compliance with specific IV-D requirements. Maintaining the Secretary's authority to audit State programs to determine compliance with IV-D requirements is essential to carrying out her oversight responsibilities for the program.

Section 305.62 Disregard of a failure which is of a technical nature.

Comment: A commenter expressed concern about the process under which OCSE will decide not to impose a penalty because of "technical non-compliance". Section 305.62 should provide a concrete definition of "technical non-compliance."

Response: It is impossible to foresee all the circumstances under which a penalty might be imposed for technical non-compliance. Thus, it is not possible to provide a concrete definition. "Technical non-compliance" is defined in a broad way allowing it to be applied to unknown situations that may occur. This definition is based on a historical application that has been used by OCSE to evaluate States' program performance.

VII. Regulatory Flexibility Analysis

The Secretary certifies, under 5 U.S.C. 605(b), the Regulatory Flexibility Act (Pub. L. 96-354), that these regulations will not result in a significant impact on a substantial number of small entities. The primary impact is on State governments. State governments are not considered small entities under the Act.

VIII. Executive Order 12866

Executive Order 12866 requires that regulations be reviewed to ensure that they are consistent with the priorities and principles set forth in the Executive Order. The Department has determined that this rule is consistent with these priorities and principles. This rule implements the statutory provisions by specifying the performance-based incentive and penalty systems.

IX. Unfunded Mandates Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (Unfunded Mandates Act) requires that a covered agency prepare a budgetary impact statement before promulgating a rule that includes any Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year.

If a covered agency must prepare a budgetary impact statement, section 205 further requires that it select the most cost-effective and least burdensome alternative that achieves the objectives of the rule and is consistent with the statutory requirements. In addition, section 203 requires a plan for informing and advising any small government that may be significantly or uniquely impacted by the rule.

We have determined that these rules will not result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of more than \$100 million in any one year. Accordingly, we have not prepared a budgetary impact statement, specifically addressed the regulatory alternatives considered, or prepared a plan for informing and advising any significantly or uniquely impacted small government.

X. Paperwork Reduction Act

Under the Paperwork Reduction Act of 1995, Public Law 104-13, all Departments are required to submit to the Office of Management and Budget (OMB) for review and approval any reporting or recordkeeping requirements inherent in a proposed or final rule. The reports necessary to implement this rule have received OMB approvals. They are the OCSE-157, OMB No. 0970-0177; the OCSE-34A, OMB No. 0970-0181; and the OCSE-396A, OMB No. 0970-0181. This rule requires no other reporting or recordkeeping requirements.

XI. Congressional Review

This rule is not a major rule as defined in 5 U.S.C., Chapter 8.

XII. Assessment of Federal Regulations and Policies on Families

Section 654 of the Treasury and General Government Appropriations Act of 1999 requires Federal agencies to determine whether a proposed policy or regulation may affect family well-being. If the agency's conclusion is affirmative, then the agency must prepare an impact assessment addressing seven criteria specified in the law. These regulations will not have an impact on family well-being as defined in the legislation. This regulation provides an alternative

system to reward good performance and sanction poor performance and the new system, like its predecessor, will positively impact families needing support.

XIII. Executive Order 13132 Federalism Assessment

Executive Order 13132 on Federalism applies to policies that have federalism implications, defined as "regulations, legislative comments or proposed legislation, and other policy statements or actions that have substantial direct effects on the States, on the relationship between the national government and the States, or on the distributions of power and responsibilities among the various levels of government." This rule does not have federalism implications for State or local governments as defined in the executive order.

List of Subjects*45 CFR parts 302 and 303*

Child support, Grant programs/social programs, Reporting and recordkeeping requirements.

45 CFR part 304

Child support, Grant programs/social programs, Penalties, Reporting and recordkeeping requirements, Unemployment compensation.

45 CFR part 305

Child support, Grant programs/social programs, Accounting.

(Catalog of Federal Domestic Assistance Programs No. 93.563, Child Support Enforcement Program)

Dated: August 17, 2000.

Olivia A. Golden,

Assistant Secretary for Children and Families.

Dated: August 23, 2000.

Donna E. Shalala,

Secretary, Department of Health and Human Services.

For the reasons discussed above, we amend title 45 CFR Chapter III of the Code of Federal Regulations as follows:

PART 302—STATE PLAN REQUIREMENTS

1. The authority citation for part 302 is revised to read as follows:

Authority: 42 U.S.C. 651 through 658A, 660, 664, 666, 667, 1302, 1396(a)(25), 1396B(d)(2), 1396b(o), 1396(p), 1396(k).

§ 302.55 [Amended]

2. Section 302.55 is amended by adding the words "and part 305" after "§ 304.12".

PART 303—STANDARDS FOR PROGRAM OPERATIONS

3. The authority section for part 303 continues to read as follows:

Authority: 42 U.S.C. 651 through 658, 660, 663, 664, 667, 1302, 1396a(a)(25), 1396b(d)(2), 1396b(o), 1396b(p), and 1396(k).

4. A new § 303.35 is added to read as follows:

§ 303.35 Administrative complaint procedure.

(a) Each State must have in place an administrative complaint procedure, defined by the State, in place to allow individuals the opportunity to request an administrative review, and take appropriate action when there is evidence that an error has occurred or an action should have been taken on their case. This includes both individuals in the State and individuals from other States.

(b) A State need not establish a formal hearing process but must have clear procedures in place. The State must notify individuals of the procedures, make them available for recipients of IV-D services to use when requesting such a review, and use them for notifying recipients of the results of the review and any actions taken.

PART 304—FEDERAL FINANCIAL PARTICIPATION

5. The authority citation for part 304 continues to read as follows:

Authority: 42 U.S.C. 651 through 655, 657, 658, 1302, 1396(a)(25), 1396b(d)(2), 1396b(o), 1396(p), and 1396(k).

6. Section 304.12 is amended by adding new paragraphs (d) and (e) to read as follows:

§ 304.12 Incentive payments.

* * * * *

(d) *Effective date.* This section is in effect only through September 30, 2001.

(e) *Phase in process.* The amounts payable under this section will be reduced by one-third for fiscal year 2000 and two-thirds for fiscal year 2001.

PART 305—PROGRAM PERFORMANCE MEASURES, STANDARDS, FINANCIAL INCENTIVES, AND PENALTIES

7. A new part 305 is added to read as follows:

Sec.

305.0 Scope.

305.1 Definitions.

305.2 Performance measures.

305.31 Amount of incentive payment.

305.32 Requirements applicable to calculations.

305.33 Determination of applicable percentages based on performance levels.

- 305.34 Payment of incentives.
- 305.35 Reinvestment.
- 305.36 Incentive phase-in.
- 305.40 Penalty performance measures and levels.
- 305.42 Penalty phase-in.
- 305.60 Types and scope of Federal audits.
- 305.61 Penalty for failure to meet IV-D requirements.
- 305.62 Disregard of a failure which is of a technical nature.
- 305.63 Standards for determining substantial compliance with IV-D requirements.
- 305.64 Audit procedures and State comments.
- 305.65 State cooperation in the audit.
- 305.66 Notice, corrective action year, and imposition of penalty.

Authority: 42 U.S.C. 609(a)(8), 652(a)(4) and (g), 658A and 1302.

§ 305.0 Scope.

This part implements the incentive system requirements as described in section 458A (to be redesignated as section 458 effective October 1, 2001) of the Act and the penalty provisions as required in sections 409(a)(8) and 452(g) of the Act. This part also implements Federal audit requirements under sections 409(a)(8) and 452(a)(4) of the Act. Sections 305.0 through 305.2 contain general provisions applicable to this part. Sections 305.31 through 305.36 of this part describe the incentive system. Sections 305.40 through 305.42 and §§ 305.60 through 305.66 describe the penalty and audit processes.

§ 305.1 Definitions.

The definitions found in § 301.1 of this chapter are also applicable to this part. In addition, for purposes of this part:

(a) The term *IV-D case* means a parent (mother, father, or putative father) who is now or eventually may be obligated under law for the support of a child or children receiving services under the title IV-D program. A parent is a separate IV-D case for each family with a dependent child or children that the parent may be obligated to support. If both parents are absent and liable or potentially liable for support of a child or children receiving services under the IV-D program, each parent is considered a separate IV-D case. In counting cases for the purposes of this part, States may exclude cases closed under § 303.11 and cases over which the State has no jurisdiction. Lack of jurisdiction cases are those in which a non-custodial parent resides in the civil jurisdictional boundaries of another country or federally recognized Indian

Tribe and no income or assets of this individual are located or derived from outside that jurisdiction and the State has no other means through which to enforce the order.

(b) The term *Current Assistance collections* means collections received and distributed on behalf of individuals whose rights to support are required to be assigned to the State under title IV-A of the Act, under title IV-E of the Act, or under title XIX of the Act. In addition, a referral to the State's IV-D agency must have been made.

(c) The term *Former Assistance collections* means collections received and distributed on behalf of individuals whose rights to support were formerly required to be assigned to the State under title IV-A (TANF or Aid to Families with Dependent Children, AFDC), title IV-E (Foster Care), or title XIX (Medicaid) of the Act.

(d) The term *Never Assistance/Other collections* means all other collections received and distributed on behalf of individuals who are receiving child support enforcement services under title IV-D of the Act.

(e) The term *total IV-D dollars expended* means total IV-D administrative expenditures claimed by a State in a specified fiscal year adjusted in accordance with § 305.32 of this part.

(f) The term *Consumer Price Index or CPI* means the last Consumer Price Index for all-urban consumers published by the Department of Labor. The CPI for a fiscal year is the average of the Consumer Price Index for the 12-month period ending on September 30 of the fiscal year.

(g) The term *State incentive payment share for a fiscal year* means the incentive base amount for the State for the fiscal year divided by the sum of the incentive base amounts for all of the States for the fiscal year.

(h) The term *incentive base amount for a fiscal year* means the sum of the State's performance level percentages (determined in accordance with § 305.33) multiplied by the State's corresponding maximum incentive base on each of the following measures:

- (1) The paternity establishment performance level;
- (2) The support order performance level;
- (3) The current collections performance level;
- (4) The arrears collections performance level; and
- (5) The cost-effectiveness performance level.

(i) The term *reliable data*, means the most recent data available which are

found by the Secretary to be reliable and is a state that exists when data are sufficiently complete and error free to be convincing for their purpose and context. State data must meet a 95 percent standard of reliability effective beginning in fiscal year 2001. This is with the recognition that data may contain errors as long as they are not of a magnitude that would cause a reasonable person, aware of the errors, to doubt a finding or conclusion based on the data.

(j) The term *complete data* means all reporting elements from OCSE reporting forms, necessary to compute a State's performance levels, incentive base amount, and maximum incentive base amount, have been provided within timeframes established in instructions to these forms and § 305.32(f) of this part.

§ 305.2 Performance measures.

(a) The child support incentive system measures State performance levels in five program areas:

Paternity establishment; support order establishment; current collections; arrearage collections; and cost-effectiveness. The penalty system measures State performance in three of these areas: Paternity establishment; establishment of support orders; and current collections.

(1) *Paternity Establishment Performance Level.* States have the choice of being evaluated on one of the following two measures for their paternity establishment percentage (commonly known as the PEP). The count of children shall not include any child who is a dependent by reason of the death of a parent (unless paternity is established for that child). It shall also not include any child whose parent is found to have good cause for refusing to cooperate with the State agency in establishing paternity, or for whom the State agency determines it is against the best interest of the child to pursue paternity issues.

(i) *IV-D Paternity Establishment Percentage* means the ratio that the total number of children in the IV-D caseload in the fiscal year (or, at the option of the State, as of the end of the fiscal year) who have been born out-of-wedlock and for whom paternity has been established or acknowledged, bears to the total number of children in the IV-D caseload as of the end of the preceding fiscal year who were born out-of-wedlock. The equation to compute the measure is as follows (expressed as a percent):

Total # of Children in IV - D Caseload in the Fiscal Year or,
 at the option of the State, as of the end of the Fiscal Year who were
Born Out - of - Wedlock with Paternity Established or Acknowledged
 Total # of Children in IV - D Caseload as of the end of the preceding
 Fiscal Year who were Born Out - of - Wedlock

(ii) *Statewide Paternity Establishment Percentage* means the ratio that the total number of minor children who have been born out-of-wedlock and for whom paternity has been established or acknowledged during the fiscal year, bears to the total number of children born out-of-wedlock during the preceding fiscal year. The equation to compute the measure is as follows (expressed as a percent):

$$\frac{\text{Total \# of Minor Children who have been Born Out - of - Wedlock and for Whom Paternity has been Established or Acknowledged During the Fiscal Year}}{\text{Total \# of Children Born Out of Wedlock During the Preceding Fiscal Year}}$$

(2) *Support Order Establishment Performance Level*. This measure requires a determination of whether or not there is a support order for each case. These support orders include all types of legally enforceable orders, such as court, default, and administrative. Since the measure is a case count at a point-in-time, modifications to an order do not affect the count. The equation to compute the measure is as follows (expressed as a percent):

$$\frac{\text{Number of IV - D Cases with Support Orders During the Fiscal Year}}{\text{Total Number of IV - D Cases During the Fiscal Year}}$$

(3) *Current Collections Performance Level*. Current support is money applied to current support obligations and does not include payment plans for payment towards arrears. If included, voluntary collections must be included in both the numerator and the denominator. This measure is computed monthly and the total of all months is reported at the end of the year. The equation to compute the measure is as follows (expressed as a percent):

$$\frac{\text{Number Dollars Collected for Current Support in IV - D Cases}}{\text{Total Dollars Owed for Current Support in IV - D Cases}}$$

(4) *Arrearage Collection Performance Level*. This measure includes those cases where all of the past-due support was disbursed to the family, or retained by the State because all the support was assigned to the State. If some of the past-due support was assigned to the State and some was to be disbursed to the family, only those cases where some of the support actually went to the family can be included. The equation to compute the measure is as follows (expressed as a percent):

$$\frac{\text{Total number of eligible IV - D cases paying toward arrears}}{\text{Total number of IV - D cases with arrears due}}$$

(5) *Cost-Effectiveness Performance Level*. Interstate incoming and outgoing distributed collections will be included for both the initiating and the responding State in this measure. The equation to compute this measure is as follows (expressed as a ratio):

$$\frac{\text{Total IV - D Dollars Collected}}{\text{Total IV - D Dollars Expended}}$$

(b) For incentive purposes, the measures will be weighted in the following manner. Each State will earn five scores based on performance on each of the five measures. Each of the first three measures (paternity establishment, order establishment, and current collections) earn 100 percent of the collections base as defined in § 305.31(e) of this part. The last two measures (collections on arrears and cost-effectiveness) earn a maximum of 75 percent of the collections base as defined in § 305.31(e) of this part.

§ 305.31 Amount of incentive payment.

(a) The incentive payment for a State for a fiscal year is equal to the incentive payment pool for the fiscal year,

multiplied by the State incentive payment share for the fiscal year.

(b) The incentive payment pool is:

- (1) \$422,000,000 for fiscal year 2000;
- (2) \$429,000,000 for fiscal year 2001;
- (3) \$450,000,000 for fiscal year 2002;
- (4) \$461,000,000 for fiscal year 2003;
- (5) \$454,000,000 for fiscal year 2004;
- (6) \$446,000,000 for fiscal year 2005;
- (7) \$458,000,000 for fiscal year 2006;
- (8) \$471,000,000 for fiscal year 2007;
- (9) \$483,000,000 for fiscal year 2008;

and

(10) For any succeeding fiscal year, the amount of the incentive payment pool for the fiscal year that precedes such succeeding fiscal year multiplied by the percentage (if any) by which the CPI for such preceding fiscal year exceeds the CPI for the second preceding fiscal year. In other words, for each fiscal year following fiscal year 2008, the incentive payment pool will be multiplied by the percentage increase in the CPI between the two preceding years. For example, if the CPI increases by 1 percent between fiscal years 2007 and 2008, then the incentive pool for fiscal year 2009 would be a 1 percent increase over the \$483,000,000 incentive payment pool for fiscal year 2008, or \$487,830,000.

(c) The State incentive payment share for a fiscal year is the incentive base amount for the State for the fiscal year divided by the sum of the incentive base amounts for all of the States for the fiscal year.

(d) A State's maximum incentive base amount for a fiscal year is the State's collections base for the fiscal year for the paternity establishment, support order, and current collections performance measures and 75 percent of the State's collections base for the fiscal year for the arrearage collections and cost-effectiveness performance measures.

(e) A State's maximum incentive base amount for a State for a fiscal year is zero, unless a Federal audit performed under § 305.60 of this part determines that the data submitted by the State for the fiscal year and used to determine the performance level involved are complete and reliable.

(f) A State's collections base for a fiscal year is equal to: two times the sum of the total amount of support collected for Current Assistance cases plus two times the total amount of support collected in Former Assistance cases, plus the total amount of support collected in Never Assistance/other cases during the fiscal year, that is: 2(Current Assistance collections + Former Assistance collections) + all other collections.

§ 305.32 Requirements applicable to calculations.

In calculating the amount of incentive payments or penalties, the following conditions apply:]

(a) Each measure is based on data submitted for the Federal fiscal year. The Federal fiscal year runs from October 1st of one year through September 30th of the following year.

(b) Only those Current Assistance, Former Assistance and Never Assistance/other collections disbursed and those expenditures claimed by the State in the fiscal year will be used to determine the incentive payment payable for that fiscal year;

(c) Support collected by one State at the request of another State will be treated as having been collected in full by each State;

(d) Amounts expended by the State in carrying out a special project under section 455(e) of the Act will be excluded from the State's total IV-D dollars expended in computing incentive payments;

(e) Fees paid by individuals, recovered costs, and program income such as interest earned on collections will be deducted from total IV-D dollars expended; and

(f) States must submit data used to determine incentives and penalties following instructions and formats as required by HHS on Office of Management and Budget (OMB) approved reporting instruments. Data necessary to calculate performance for incentives and penalties for a fiscal year must be submitted to the Office of Child Support Enforcement by December 31st, the end of the first quarter after the end of the fiscal year. Only data submitted as of December 31st will be used to determine the State's performance for the prior fiscal year and the amount of incentive payments due the States.

§ 305.33 Determination of applicable percentages based on performance levels.

(a) A State's paternity establishment performance level for a fiscal year is, at the option of the State, the IV-D paternity establishment percentage or the Statewide paternity establishment percentage determined under § 305.2 of this part. The applicable percentage for each level of a State's paternity establishment performance can be found in table 1 of this part, except as provided in paragraph (b) of this section.

(b) If the State's paternity establishment performance level for a fiscal year is less than 50 percent, but exceeds its paternity establishment performance level for the immediately preceding fiscal year by at least 10

percentage points, then the State's applicable percentage for the paternity establishment performance level is 50 percent.

(c) A State's support order establishment performance level for a fiscal year is the percentage of the total number of cases where there is a support order determined under §§ 305.2 and 305.32 of this part. The applicable percentage for each level of a State's support order establishment performance can be found on table 1 of this part, except as provided in paragraph (d) of this section.

(d) If the State's support order establishment performance level for a fiscal year is less than 50 percent, but exceeds the State's support order establishment performance level for the immediately preceding fiscal year by at least 5 percentage points, then the State's applicable percentage is 50 percent.

TABLE 1.—USE THIS TABLE TO DETERMINE THE APPLICABLE PERCENTAGE LEVELS FOR THE PATERNITY ESTABLISHMENT AND SUPPORT ORDER ESTABLISHMENT PERFORMANCE MEASURES.

If the Paternity Establishment or Support Order Establishment Performance Level Is:

At least: (percent)	But less than: (percent)	The applica- ble percent- age is:
80	100
79	80	98
78	79	96
77	78	94
76	77	92
75	76	90
74	75	88
73	74	86
72	73	84
71	72	82
70	71	80
69	70	79
68	69	78
67	68	77
66	67	76
65	66	75
64	65	74
63	64	73
62	63	72
61	62	71
60	61	70
59	60	69
58	59	68
57	58	67
56	57	66
55	56	65
54	55	64
53	54	63
52	53	62
51	52	61
50	51	60
0	50	0

(e) A State's current collections performance level for a fiscal year is equal to the total amount of current support collected during the fiscal year divided by the total amount of current support owed during the fiscal year in all IV-D cases, determined under §§ 305.2 and 305.32 of this part. The applicable percentage with respect to a State's current collections performance level can be found on table 2, except as provided in paragraph (f) of this section.

(f) If the State's current collections performance level for a fiscal year is less than 40 percent but exceeds the current collections performance level of the State for the immediately preceding fiscal year by at least 5 percentage points, then the State's applicable percentage is 50 percent. r

(g) A State's arrearage collections performance level for a fiscal year is equal to the total number of IV-D cases in which payments of past-due child support were received and distributed during the fiscal year, divided by the total number of IV-D cases in which there was past-due child support owed, as determined under §§ 305.2 and 305.32 of this part. The applicable percentage with respect to a State's arrearage collections performance level can be found on table 2 except as provided in paragraph (h) of this section.

(h) If the State's arrearage collections performance level for a fiscal year is less than 40 percent but exceeds the arrearage collections performance level for the immediately preceding fiscal year by at least 5 percentage points, then the State's applicable percentage is 50 percent.

TABLE 2.—IF THE CURRENT COLLECTIONS OR ARREARAGE COLLECTIONS PERFORMANCE LEVEL IS:

(Use this table to determine the percentage levels for the current collections and arrearage collections performance measures.)

At least (percent)	But less than: (percent)	The applicable percentage is: (percent)
80	100
79	80	98
78	79	96
77	78	94
76	77	92
75	76	90
74	75	88
73	74	86
72	73	84
71	72	82
70	71	80
69	70	79
68	69	78

TABLE 2.—IF THE CURRENT COLLECTIONS OR ARREARAGE COLLECTIONS PERFORMANCE LEVEL IS:—Continued

(Use this table to determine the percentage levels for the current collections and arrearage collections performance measures.)

At least (percent)	But less than: (percent)	The applicable percentage is: (percent)
67	68	77
66	67	76
65	66	75
64	65	74
63	64	73
62	63	72
61	62	71
60	61	70
59	60	69
58	59	68
57	58	67
56	57	66
55	56	65
54	55	64
53	54	63
52	53	62
51	52	61
50	51	60
49	50	59
48	49	58
47	48	57
46	47	56
45	46	55
44	45	54
43	44	53
42	43	52
41	42	51
40	41	50
0	40	0

(i) A State's cost-effectiveness performance level for a fiscal year is equal to the total amount of IV-D support collected and disbursed or retained, as applicable during the fiscal year, divided by the total amount expended during the fiscal year, as determined under §§ 305.2 and 305.32 of this part. The applicable percentage with respect to a State's cost-effectiveness performance level can be found on table 3.

TABLE 3.—IF THE COST-EFFECTIVENESS PERFORMANCE LEVEL IS:

(Use this table to determine the percentage level for the cost-effectiveness performance measure.)

At least:	But less than:	The app. % is
5.00	100
4.50	4.99	90
4.00	4.50	80
3.50	4.00	70
3.00	3.50	60
2.50	3.00	50
2.00	2.50	40

TABLE 3.—IF THE COST-EFFECTIVENESS PERFORMANCE LEVEL IS:—Continued

(Use this table to determine the percentage level for the cost-effectiveness performance measure.)

At least:	But less than:	The app. % is
0.00	2.00	0

§ 305.34 Payment of incentives.

(a) Each State must report one-fourth of its estimated annual incentive payment on each of its four quarterly collections' reports for a fiscal year. When combined with the amounts claimed on each of the State's four quarterly expenditure reports, the portion of the annual estimated incentive payment as reported each quarter will be included in the calculation of the next quarterly grant awarded to the State under title IV-D of the Act.

(b) Following the end of each fiscal year, HHS will calculate the State's annual incentive payment, using the actual collection and expenditure data and the performance data submitted by December 31st by the State and other States for that fiscal year. A positive or negative grant will then be awarded to the State under title IV-D of the Act to reconcile an actual annual incentive payment that has been calculated to be greater or lesser, respectively, than the annual incentive payment estimated prior to the beginning of the fiscal year.

(c) Payment of incentives is contingent on a State's data being determined complete and reliable by Federal auditors.

§ 305.35 Reinvestment.

(a) A State must expend the full amount of incentive payments received under this part to supplement, and not supplant, other funds used by the State to carry out IV-D program activities or funds for other activities approved by the Secretary which may contribute to improving the effectiveness or efficiency of the State's IV-D program, including cost-effective contracts with local agencies, whether or not the expenditures for the activity are eligible for reimbursement under this part.

(b) In those States in which incentive payments are passed through to political subdivisions or localities, such payments must be used in accordance with this section.

(c) State IV-D expenditures may not be reduced as a result of the receipt and reinvestment of incentive payments.

(d) A base amount will be determined by subtracting the amount of incentive funds received and reinvested in the State IV-D program for fiscal year 1998 from the total amount expended by the State in the IV-D program during the same period. Alternatively, States have an option of using the average amount of the previous three fiscal years (1996, 1997, and 1998) as a base amount. This base amount of State spending must be maintained in future years. Incentive payments under this part must be used in addition to, and not in lieu of, the base amount.

(e) Requests for approval of expending incentives on activities not currently eligible for funding under the IV-D program, but which would benefit the IV-D program, must be submitted in accordance with instructions issued by the Commissioner of the Office of Child Support Enforcement.

§ 305.36 Incentive phase-in.

The incentive system under this part will be phased-in over a three-year period during which both the old system and the new system will be used to determine the amount a State will receive. For fiscal year 2000, a State will receive two-thirds of what it would have received under the incentive formula set forth in § 304.12 of this chapter, and one-third of what it would receive under the formula set forth under this part. In fiscal year 2001, a State will receive one-third of what it would have received under the incentive formula set forth under § 304.12 of this chapter and two-thirds of what it would receive under the formula under this part. In fiscal year 2002, the formula set forth under this part will be fully implemented and would be used to determine all incentive amounts.

§ 305.40 Penalty performance measures and levels.

(a) There are three performance measures for which States must achieve certain levels of performance in order to avoid being penalized for poor performance. These measures are the paternity establishment, support order establishment, and current collections measures set forth in § 305.2 of this part. The levels the State must meet are:

(1) *The paternity establishment percentage* which is required under section 452(g) of the Act for penalty purposes. States have the option of using either the IV-D paternity establishment percentage or the statewide paternity establishment percentage defined in § 305.2 of this part. Table 4 shows the level of performance at which a State will be subject to a penalty under the paternity establishment measure.

TABLE 4.—STATUTORY PENALTY PERFORMANCE STANDARDS FOR PATERNITY ESTABLISHMENT
(Use this table to determine the level of performance for the paternity establishment measure that will incur a penalty.)

PEP	Increase required over previous year's PEP	Penalty FOR FIRST FAILURE if increase not met
90% or more	None	No Penalty.
75% to 89%	2%	1-2% TANF Funds.
50% to 74%	3%	1-2% TANF Funds.
45% to 49%	4%	1-2% TANF Funds.
40% to 44%	5%	1-2% TANF Funds.
39% or less	6%	1-2% TANF Funds.

(2) The support order establishment performance measure is set forth in § 305.2 of this part. For purposes of the penalty with respect to this measure, there is a threshold of 40 percent, below which a State will be penalized unless an increase of 5 percent over the previous year is achieved—which will qualify it for an incentive. Performance in the 40 percent to 49 percent range with no significant increase will not be penalized but neither will it qualify for an incentive payment. Table 5 shows at which level of performance a State will incur a penalty under the child support order establishment measure.

TABLE 5.—PERFORMANCE STANDARDS FOR ORDER ESTABLISHMENT
(Use this table to determine the level of performance for the order establishment measure that will incur a penalty.)

Performance level	Increase over previous year	Incentive/Penalty
50% or more	no increase over previous year required	Incentive.
40% to 49%	w/5% increase over previous year	Incentive.
	w/out 5% increase	No Incentive/No Penalty.
Less than 40%	w/5% increase over previous year	Incentive.
	w/out 5% increase	Penalty equal to 1-2% of TANF funds for the first failure, 2-3% for second failure, and so forth, up to a maximum of 5% of TANF funds.

(3) The *current collections* performance measure is set forth in § 305.2 of this part. There is a threshold of 35 percent below which a State will be penalized unless an increase of 5 percent over the previous year is achieved (that qualifies it for an incentive). Performance in the 35 percent to 40 percent range with no significant increase will not be penalized but neither will it qualify for an incentive payment. Table 6 shows at which level of performance the State will incur a penalty under the current collections measure.

TABLE 6.—PERFORMANCE STANDARDS FOR CURRENT COLLECTIONS
(Use this table to determine the level of performance for the current collections measure that will incur a penalty.)

Performance level	Increase over previous year	Incentive/Penalty
40% or more	no increase over previous year required	Incentive.
35% to 39%	w/5% increase over previous year	Incentive.
	w/out 5% increase	No Incentive/No Penalty.
less than 35%	w/5% increase over previous year	Incentive.
	w/out 5% increase	Penalty equal to 1–2% of TANF funds for the first failure, 2–3% for second failure, and so forth, up to a maximum of 5% of TANF funds.

(b) The provisions listed under § 305.32 of this part also apply to the penalty performance measures.

§ 305.42 Penalty phase-in.

States are subject to the performance penalties described in § 305.40 based on data reported for FY 2001. Data reported for FY 2000 will be used as a base year to determine improvements in performance during FY 2001. There will be an automatic one-year corrective action period before any penalty is assessed. The penalties will be assessed and then suspended during the corrective action period.

§ 305.60 Types and scope of Federal audits.

(a) OCSE will conduct audits, at least once every three years (or more frequently if the State fails to meet performance standards and reliability of data requirements) to assess the completeness, authenticity, reliability, accuracy and security of data and the systems used to process the data in calculating performance indicators under this part;

(b) Also, OCSE will conduct audits to determine the adequacy of financial management of the State IV–D program, including assessments of:

(1) Whether funds to carry out the State program are being appropriately expended, and are properly and fully accounted for; and

(2) Whether collections and disbursements of support payments are carried out correctly and are fully accounted for; and

(c) OCSE will conduct audits for such other purposes as the Secretary may find necessary.

(1) These audits include audits to determine if the State is substantially complying with one or more of the requirements of the IV–D program (with the exception of the requirements of section 454(24) of the Act relating to statewide-automated systems and section 454(27)(A) and (B)(i) relating to the State Disbursement Unit) as defined in § 305.63 of this part. Other audits will be conducted at the discretion of OCSE.

(2) Audits to determine substantial compliance will be initiated based on substantiated evidence of a failure by the State to meet IV–D program requirements. Evidence, which could warrant an audit to determine substantial compliance, includes:

(i) The results of two or more State self-reviews conducted under section 454(15)(A) of the Act which: Show evidence of sustained poor performance; or indicate that the State has not corrected deficiencies identified in previous self-assessments, or that those deficiencies are determined to seriously impact the performance of the State’s program; or

(ii) Evidence of a State program’s systemic failure to provide adequate services under the program through a pattern of non-compliance over time.

(d) OCSE will conduct audits of the State’s IV–D program through inspection, inquiries, observation, and confirmation and in accordance with standards promulgated by the Comptroller General of the United States in “Government Auditing Standards.”

§ 305.61 Penalty for failure to meet IV–D requirements.

(a) A State will be subject to a financial penalty and the amounts otherwise payable to the State under title IV–A of the Act will be reduced in accordance with § 305.66:

(1) If on the basis of:

(i) Data submitted by the State or the results of an audit conducted under § 305.60 of this part, the State’s program failed to achieve the paternity establishment percentages, as defined in section 452(g)(2) of the Act and § 305.40 of this part, or to meet the support order establishment and current collections performance measures as set forth in § 305.40 of this part; or

(ii) The results of an audit under § 305.60 of this part, the State did not submit complete and reliable data, as defined in § 305.1 of the part; or

(iii) The results of an audit under § 305.60 of this part, the State failed to

substantially comply with one or more of the requirements of the IV–D program, as defined in § 305.63; and

(2) With respect to the immediately succeeding fiscal year, the State failed to take sufficient corrective action to achieve the appropriate performance levels or compliance or the data submitted by the State are still incomplete and unreliable.

(b) The reductions under paragraph (c) of this section will be made for quarters following the end of the corrective action year and will continue until the end of the first quarter throughout which the State, as appropriate:

(1) Has achieved the paternity establishment percentages, the order establishment or the current collections performance measures set forth in § 305.40 of this part;

(2) Is in substantial compliance with IV–D requirements as defined in § 305.63 of this part; or

(3) Has submitted data that are determined to be complete and reliable.

(c) The payments for a fiscal year under title IV–A of the Act will be reduced by the following percentages:

(1) One to two percent for the first finding under paragraph (a) of this section;

(2) Two to three percent for the second consecutive finding; and

(3) Not less than three percent and not more than 5 percent for the third or a subsequent consecutive finding.

(d) The reduction will be made in accordance with the provisions of 45 CFR 262.1(b)–(e) and 262.7.

§ 305.62 Disregard of a failure which is of a technical nature.

A State subject to a penalty under § 305.61(a)(1)(ii) or (iii) of this part may be determined, as appropriate, to have submitted adequate data or to have achieved substantial compliance with

one or more IV–D requirements, as defined in § 305.63 of this part, if the Secretary determines that the incompleteness or unreliability of the data, or the noncompliance with one or more of the IV–D requirements, is of a technical nature which does not adversely affect the performance of the State's IV–D program or does not adversely affect the determination of the level of the State's paternity establishment or other performance measures percentages.

§ 305.63 Standards for determining substantial compliance with IV–D requirements.

For the purposes of a determination under § 305.61(a)(1)(iii) of this part, in order to be found to be in substantial compliance with one or more of the IV–D requirements as a result of an audit conducted under § 305.60 of this part, a State must meet the standards set forth below for each specific IV–D State plan requirement or requirements being audited and contained in parts 302 and 303 of this chapter, measured as follows:

(a) The State must meet the requirements under the following areas:

(1) Statewide operations, § 302.10 of this chapter;

(2) Reports and maintenance of records, § 302.15(a) of this chapter;

(3) Separation of cash handling and accounting functions, § 302.20 of this chapter; and

(4) Notice of collection of assigned support, § 302.54 of this chapter.

(b) The State must provide services required under the following areas in at least 90 percent of the cases reviewed:

(1) Establishment of cases, § 303.2(a) of this chapter; and

(2) Case closure criteria, § 303.11 of this chapter.

(c) The State must provide services required under the following areas in at least 75 percent of the cases reviewed:

(1) Collection and distribution of support payments, including: collection and distribution of support payments by the IV–D agency under § 302.32(b) of this chapter; distribution of support collections under § 302.51 of this chapter; and distribution of support collected in title IV–E foster care maintenance cases under § 302.52 of this chapter;

(2) Establishment of paternity and support orders, including: Establishment of a case under § 303.2(b) of this chapter; services to individuals not receiving TANF or title IV–E foster care assistance, under § 302.33(a)(1) through (4) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c)(1) through (6) and

(c)(8) through (10) of this chapter; location of non-custodial parents under § 303.3 of this chapter; establishment of paternity under § 303.5(a) and (f) of this chapter; guidelines for setting child support awards under § 302.56 of this chapter; and establishment of support obligations under § 303.4(d), (e) and (f) of this chapter;

(3) Enforcement of support obligations, including, in all appropriate cases: establishment of a case under § 303.2(b) of this chapter; services to individuals not receiving TANF or title IV–E foster care assistance, under § 302.33(a)(1) through (4) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c)(1) through (6) and (c)(8) through (10) of this chapter; location of non-custodial parents under § 303.3 of this chapter; enforcement of support obligations under § 303.6 of this chapter and State laws enacted under section 466 of the Act, including submitting once a year all appropriate cases in accordance with § 303.6(c)(3) of this chapter to State and Federal income tax refund offset; and wage withholding under § 303.100 of this chapter. In cases in which wage withholding cannot be implemented or is not available and the non-custodial parent has been located, States must use or attempt to use at least one enforcement technique available under State law in addition to Federal and State tax refund offset, in accordance with State laws and procedures and applicable State guidelines developed under § 302.70(b) of this chapter;

(4) Review and adjustment of child support orders, including: Establishment of a case under § 303.2(b) of this chapter; services to individuals not receiving TANF or title IV–E foster care assistance, under § 302.33(a)(1) through (4) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c)(1) through (6) and (c)(8) through (10) of this chapter; location of non-custodial parents under § 303.3 of this chapter; guidelines for setting child support awards under § 302.56 of this chapter; and review and adjustment of support obligations under § 303.8 of this chapter; and

(5) Medical support, including: establishment of a case under § 303.2(b) of this chapter; services to individuals not receiving TANF or title IV–E foster care assistance, under § 302.33(a)(1) through (4) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c)(1) through (6) and (c)(8) through (10) of this chapter; location of non-custodial parents under § 303.3 of this chapter; securing medical support information under § 303.30 of

this chapter; and securing and enforcing medical support obligations under § 303.31 of this chapter; and

(6) Disbursement of support payments in accordance with the timeframes in section 454B of the Act and § 302.32 of this chapter.

(d) With respect to the 75 percent standard in paragraph (b) of this section:

(1) Notwithstanding timeframes for establishment of cases in § 303.2(b) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c)(4) through (6), (c)(8) and (9) of this chapter; location and support order establishment under § 303.3(b)(3) and (5), and § 303.4(d) of this chapter, if a support order needs to be established in a case and an order is established during the audit period in accordance with the State's guidelines for setting child support awards, the State will be considered to have taken appropriate action in that case for audit purposes.

(2) Notwithstanding timeframes for establishment of cases in § 303.2(b) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c)(4) through (6), and (c)(8) and (9) of this chapter; and location and review and adjustment of support orders contained in § 303.3(b)(3) and (5), and § 303.8 of this chapter, if a particular case has been reviewed and meets the conditions for adjustment under State laws and procedures and § 303.8 of this chapter, and the order is adjusted, or a determination is made, as a result of a review, during the audit period, that an adjustment is not needed, in accordance with the State's guidelines for setting child support awards, the State will be considered to have taken appropriate action in that case for audit purposes.

(3) Notwithstanding timeframes for establishment of cases in § 303.2(b) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c) (4) through (6), and (c)(8) and (9) of this chapter; and location and wage withholding in § 303.3(b) (3) and (5), and § 303.100 of this chapter, if wage withholding is appropriate in a particular case and wage withholding is implemented and wages are withheld during the audit period, the State will be considered to have taken appropriate action in that case for audit purposes.

(4) Notwithstanding timeframes for establishment of cases in § 303.2(b) of this chapter; provision of services in interstate IV–D cases under § 303.7(a), (b) and (c) (4) through (6), and (c)(8) and (9) of this chapter; and location and enforcement of support obligations in § 303.3(b) (3) and (5), and § 303.6 of this chapter, if wage withholding is not appropriate in a particular case, and the

State uses at least one enforcement technique available under State law, in addition to Federal and State income tax refund offset, which results in a collection received during the audit period, the State will be considered to have taken appropriate action in the case for audit purposes.

(e) The State must meet the requirements for expedited processes under § 303.101(b)(2)(i) and (iii), and (e) of this chapter.

§ 305.64 Audit procedures and State comments.

(a) Prior to the start of the actual audit, Federal auditors will hold an audit entrance conference with the IV-D agency. At that conference, the auditors will explain how the audit will be performed and make any necessary arrangements.

(b) At the conclusion of audit fieldwork, Federal auditors will afford the State IV-D agency an opportunity for an audit exit conference at which time preliminary audit findings will be discussed and the IV-D agency may present any additional matter it believes should be considered in the audit findings.

(c) After the exit conference, Federal auditors will prepare and send to the IV-D agency a copy of their interim report on the results of the audit. Within a specified timeframe from the date the report was sent by certified mail, the IV-D agency may submit written comments on any part of the report which the IV-D agency believes is in error. The auditors will note such

comments and incorporate any response into the final audit report.

§ 305.65 State cooperation in audit.

(a) Each State shall make available to the Federal auditors such records or other supporting documentation (electronic and manual) as the audit staff may request, including records to support the data as submitted on the Federal statistical and financial reports that will be used to calculate the State's performance. The State shall also make available personnel associated with the State's IV-D program to provide information that the audit staff may find necessary in order to conduct or complete the audit.

(b) States must provide evidence to Office that their data are complete and reliable as defined in § 305.2 of this part.

(c) Failure to comply with the requirements of this section with respect to audits conducted to determine compliance with IV-D requirements under § 305.60 of this part, may necessitate a finding that the State has failed to comply with the particular criteria being audited.

§ 305.66 Notice, corrective action year, and imposition of penalty.

(a) If a State is found by the Secretary to be subject to a penalty as described in § 305.61 of this part, the OCSE will notify the State in writing of such finding.

(b) The notice will:

(1) Explain the deficiency or deficiencies which result in the State being subject to a penalty, indicate the

amount of the potential penalty, and give reasons for the finding; and

(2) Specify that the penalty will be assessed in accordance with the provisions of 45 CFR 262.1(b) through (e) and 262.7 if the State is found to have failed to correct the deficiency or deficiencies cited in the notice during the automatic corrective action year (i.e., the succeeding fiscal year following the year with respect to which the deficiency occurred.)

(c) The penalty under § 305.61 of this part will be assessed if the Secretary determines that the State has not corrected the deficiency or deficiencies cited in the notice by the end of the corrective action year.

(d) Only one corrective action period is provided to a State with respect to a given deficiency where consecutive findings of noncompliance are made with respect to that deficiency. In the case of a State against which the penalty is assessed and which failed to correct the deficiency or deficiencies cited in the notice by the end of the corrective action year, the penalty will be effective for any quarter after the end of the corrective action year and ends for the first full quarter throughout which the State IV-D program is determined to have corrected the deficiency or deficiencies cited in the notice.

(e) A consecutive finding occurs only when the State does not meet the same criterion or criteria cited in the notice in paragraph (a) of this section.

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