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Part II

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Food and Nutrition Service

7 CFR Part 246

Special Supplemental Nutrition Program for Women, Infants and Children (WIC): Food Delivery Systems; Proposed Rule

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

7 CFR PART 246

RIN 0584–AA80

Special Supplemental Nutrition Program for Women, Infants and Children (WIC): Food Delivery Systems

AGENCY: Food and Nutrition Service, USDA

ACTION: Proposed rule.

SUMMARY: This proposed rule would amend the regulations governing the Special Supplemental Nutrition Program for Women, Infants and Children. It would strengthen the requirements for operation of vendor management systems by establishing mandatory selection criteria; limitation of vendors; training requirements; criteria to be used to identify high-risk vendors; and monitoring requirements, including compliance buys. In addition, the rule would strengthen food instrument accountability and sanctions for participants who violate program regulations. It would also streamline the vendor appeals process. The rule is intended to ensure greater program accountability and efficiency in food delivery and related areas, and to promote a decrease in vendor violation of program requirements and loss of program funds.

DATES: To be assured of consideration, written comments must be postmarked on or before September 14, 1999. Since comments are being accepted simultaneously on several separate rulemakings, commenters on this proposed rule are asked to label their comments ''Food Delivery Systems.'' In addition, due to the inherent problems associated with the large volume of comments this rule is expected to generate, electronic transmissions, including data faxes, will not be accepted.

ADDRESSES: Comments may be mailed to Patricia Daniels, Director, Supplemental Food Programs Division, Food and Nutrition Service, USDA, 3101 Park Center Drive, Room 540, Alexandria, Virginia 22302, (703) 305–2746. All written submissions will be available for public inspection at this address during regular business hours (8:30 a.m. to 5:00 p.m.) Monday through Friday.

FOR FURTHER INFORMATION CONTACT: Barbara Hallman, at (703) 305–2730.

SUPPLEMENTARY INFORMATION:

Executive Order 12866

This proposed rule has been determined to be ''significant'' and was reviewed by the Office of Management and Budget (OMB) under Executive Order 12866.

Regulatory Flexibility Act

This rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601–612). Pursuant to that review, Shirley R. Watkins, Under Secretary, Food, Nutrition and Consumer Services, has certified that this rule would not have a significant impact on a substantial number of small entities. This rule would modify vendor selection, training, monitoring, sanction and appeal procedures and/or systems. The effect of these changes would fall primarily on State agencies. Local agencies and vendors would also be affected, some of which are small entities. However, the impact on small entities is not expected to be significant.

Executive Order 12372

The WIC Program is listed in the Catalog of Federal Domestic Assistance Programs under 10.557. For the reasons set forth in the final rule in 7 CFR part 3015, Subpart V, and related Notice (48 FR 29115), this program is included in the scope of Executive Order 12372 which requires intergovernmental consultation with State and local officials.

Executive Order 12988

This proposed rule has been reviewed under Executive Order 12988, Civil Justice Reform. This proposed rule is intended to have preemptive effect with respect to any State or local laws, regulations or policies which conflict with its provisions or which would otherwise impede its full implementation. This rule is not intended to have retroactive effect unless so specified in the **EFFECTIVE DATE** paragraph of the preamble of the final rule. Prior to any judicial challenge to the application of the provisions of the final rule, all applicable administrative procedures must be exhausted.

Unfunded Mandates Reform Act of 1995

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1531–38) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local and tribal governments and the private sector. Under section 202 of the UMRA, the Food and Nutrition Service (FNS) generally must prepare a written statement, including a cost benefit analysis, for proposed and final rules with ''Federal mandates'' that may result in expenditures to State, local or tribal governments, in the aggregate, or the private sector, of $100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires FNS to identify and consider a reasonable number of regulatory alternatives and adopt the most cost-effective or least burdensome alternative that achieves the objectives of the rule.

This proposed rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local and tribal governments or the private sector of $100 million or more in any one year. Thus, the rule is not subject to the requirements of sections 202 and 205 of the UMRA.

Paperwork Reduction Act of 1995

The following constitutes a 60-day notice issued by FNS.

Send comments and requests for copies of this information collection to Lori Schack, Desk Officer, Office of Information and Regulatory Affairs, Office of Management and Budget (OMB), Washington, DC 20503. A copy may be sent to Barbara Hallman, Branch Chief, Supplemental Food Programs Division, Food and Nutrition Service, USDA, 3101 Park Center Drive, Room 540, Alexandria, Virginia 22302, (703) 305–2746.

Comments and recommendations on the proposed information collection must be received by August 16, 1999. A comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

OMB Number: 0584–0043.

Expiration Date: 05/31/99.

Type of Request: Revision of a currently approved reporting and recordkeeping requirements.

Abstract: In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–20) (Paperwork Reduction Act), the reporting and recordkeeping burden associated with this proposed rule will be used by FNS as a principal source of information about how each State agency's food delivery system operates. This proposed rule would primarily strengthen and improve vendor management, food instrument accountability, and participant sanctions in the WIC Program. It addresses vendor selection, training, monitoring and high-risk identification and food instrument reconciliation and security. The collection and recordkeeping of this information is necessary to determine compliance with Federal regulations.

Section 246.4(a) currently requires State agencies to submit changes to State Plans annually as a prerequisite to

receipt of funds from FNS. State Plans address specific State agency program operations such as: a description of the food delivery system, including the system for the monitoring; the system for the control and reconciliation of food instruments; State agency efforts to identify the disposition of food instruments; and efforts to identify dual participation. FNS estimates that addressing the additional State plan requirements that would be required by this proposal will take each State agency 3 hours annually, for a total of 264 personhours (88 State agencies × 3 personhours per State agency) for this provision annually.

Proposed section 246.12(i)(1) and (4) would require State agencies to conduct annual vendor training and to document the contents and receipt of vendor training, in part to assure that vendors have knowledge of program rules and procedures. FNS estimates that developing the content of vendor training materials will take each State agency an average of 8 personhours per State agency or 704 total personhours annually (8 hours × 88 State agencies). FNS further estimates that participation in the annual training will take each State agency and vendor an average of 2 hours for a total of 90,176 personhours annually (2 hours × 88 State agencies plus 2 hours × 45,000 vendors). Finally, FNS estimates that it will take each State agency and each vendor approximately 15 minutes to document receipt of the training for a total estimated annual burden of 11,272 (.25 hours × 88 State agencies plus .25 hours × 45,000 vendors).

Proposed section 246.12(j)(3) would require State agencies to monitor 10 percent of its vendor population each year. The monitoring would be required to be targeted to high-risk vendors. Proposed section 246.12(j)(3)(i) would require the State agency to document the reason why it has granted a waiver from compliance buys or inventory audits for vendors identified as high risk. This will allow FNS to identify whether a State agency has taken appropriate monitoring action against high-risk vendors, thus enabling FNS to better evaluate State agency compliance with high-risk monitoring requirements. FNS estimates that 10 percent of the total vendor population, or 4,500 vendors, will be identified as high-risk and that of those, 5 percent or 225 vendors will require a waiver from compliance buys or audits. FNS estimates it will take 2 personhours for the State agency to document each waiver, resulting in a national total of 450 personhours (225 waivers × 2 hours per waiver) required for this provision annually.

Proposed section 246.12(j)(4) would require that State agencies provide documentation for all monitoring visits, including compliance buys, inventory audits, and routine monitoring visits. FNS estimates that 10 percent or 4,500 vendors will receive compliance buys. FNS estimates that the average State agency will perform three compliance buys per vendor for a total of 13,500 compliance buys annually (4,500 vendors × 3 compliance buys per vendor). FNS further estimates that each buy will require 2 hours to document, for a national total of 27,000 personhours (13,500 compliance buys × 2 hours of documentation for each buy) spent on this provision annually.

Section 246.12(q) would require State agencies to identify the disposition of all food instruments as issued or voided, and as redeemed or unredeemed. Section 246.23(a)(4) would be amended to make State agencies liable for all redeemed food instruments that are unaccounted for, unless the State agency could demonstrate the reasons for the failure to fully account for them. For example, a State agency may not be able to account for food instruments damaged in computerized processing, or by water damage. FNS estimates that each State agency will spend 40 hours a year completing this task and that a total of 3,520 personhours will be required for this provision annually (88 reports × 40 hours per report).

The proposed reporting requirement in section 246.19(b)(5) would mandate that State agencies target areas specified by FNS during local agency reviews. This would allow FNS to effectively focus State agency attention on problem areas of program management needing intensive review and correction. State agencies review all of their local agencies once every 2 years. This means that half (1000) of all (2000) local agencies will be reviewed annually. FNS estimates that State agencies will be required to address targeted areas during local agency reviews once every 4 years. This means that an average of 250 (1000 × ¼) targeted reviews will be performed annually. FNS further estimates that it will take 2 hours for the State agency to address targeted areas during management evaluations and report the results of the targeted reviews to FNS. Therefore, 500 total personhours (250 targeted reviews per year × 2 hours per review) is estimated for this provision.

The proposed amendments to section 246.23(c)(1) would require State agencies to maintain on file documentation of the disposition of cases involving improperly obtained benefits. FNS estimates that this effort will take each of the 88 State agencies an average of 5 personhours per year, for a national total of 440 personhours (5 hours of recordkeeping a year × 88 State agencies) estimated for this provision annually.

Respondents: State agencies and vendors.

Estimated Number Respondents: State Agencies: 88 and Vendors: 45,000.

Estimate of Burden: The proposed estimates of the reporting burden by this rule are detailed below.

Proposed section and title	Estimated number of respondents	Reports filed annually	Total annual responses	Estimated avg. number of person-hours	Estimated total person-hours
246.4(a) State Plan	88	1	88	3	264
246.12(i)(1) Development of Vendor Training.	88	1	88	8	704
246.12(i)(1) Actual Vendor Training	88—State		88	2	176
	45,000—Vendors		45,000	2	90,000
246.12(i)(4) Documenting Training Receipt.	88	1	88	.25	22
	45,000		45,000	.25	11,250
246.12(j)(3) Waiver from Compliance Buys/Audits.	88	1	225	2	450
246.12(j)(4) Documenting Monitoring Visits.	88	1	13,500	2	27,000
246.12(q) Disposition of Food Instruments.	88	1	8	40	3,520

Proposed section and title	Estimated number of respondents	Reports filed annually	Total annual responses	Estimated avg. number of person-hours	Estimated total person-hours
246.19(b)(5) Targeted Reviews of Local Agencies.	88	1	250	2	500
246.23(c)(1) Disposition of Participant Claims.	88	1	88	5	440
Total	90,792		104,503		134,326

In accordance with the Paperwork Reduction Act, this proposed regulation invites the general public and other public agencies to comment on the information collection burdens that would result from the adoption of the proposals in the rule.

Comments are invited on: (a) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (b) the accuracy of the agency's estimate of the burden of the proposed collection of information including the validity of the methodology and assumptions used; (c)ways to enhance the quality, utility and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on those who respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology.

All responses to this proposed rule will be summarized and included in the request for OMB approval. All comments will also become a matter of public record.

This proposed rule contains information collection requirements which are subject to review by OMB under the Paperwork Reduction Act. The reporting and recordkeeping requirements established by this rulemaking in sections 246.4(a), 246.12(i)(1), 246.12(i)(4), 246.12(j)(3), 246.12(j)(4), 246.12(q), 246.19(b)(5), 246.23(c)(1), and 246.25(c) are pending review by OMB.

References

(1) WIC State Agency Guide to Vendor Monitoring and Fraud and Abuse Control: Grant No. FNS–59–3198–0–96 (April 1982). Prepared by Arthur W. Burger and Steven Stollmack, ANALOGS, Incorporated. This study identifies methods for reducing vendor fraud and abuse in the WIC Program.

(2) Applied Research on Vendor Abuse: Grant No. FNS–59–3198–1–117 (June 1985). Produced by David Kornetsky, Nancy Wogman, and the Massachusetts WIC Program. This study worked with a consortium of ten State agencies to design a high-risk vendor identification system.

(3) WIC Compliance Buy Handbook: produced by USDA (June 1985). This handbook provides guidance for State agencies in conducting WIC compliance investigations.

(4) National Vendor Audit: Audit Report 27661–2–Ch, Special Supplemental Food Program for Women, Infants and Children—Vendor Monitoring and Food Instrument Delivery Systems (June 15, 1988). Conducted by the Office of Inspector General (OIG), USDA.

(5) Vendor Management Study (1990): Contract No. 53–3198–5–33 (December 1990). Conducted for FNS by Professional Management Associates. This study surveyed the 50 geographic WIC State agencies and the District of Columbia, excluding Vermont and Mississippi, which provide benefits exclusively through home food delivery and direct distribution, respectively.

(6) WIC Vendor Issues Study: Contract No. 53–3198–9–53 (May 1991). Conducted for FNS by Aspen Systems Corporation. This study investigated the extent of program losses due to fraud and program noncompliance from vendor overcharging in the WIC Program.

(7) The WIC Files: Case Studies of Vendor Audits and Investigations in the WIC Program (June 1991). Produced by the vendor managers of Southeast Region in cooperation with the Florida WIC Program.

(8) National Association of WIC Directors (NAWD) National Vendor Management Roundup Survey (1995). This survey, designed by FNS and the NAWD Vendor Committee representatives, provided profile date on State agency vendor management information systems.

(9) Vendor Activity Monitoring Profile (VAMP, 1996): Produced annually by the USDA. This report analyzes WIC State agency vendor monitoring activities. The report discusses the safeguards that exist to prevent vendor fraud and program noncompliance from occurring.

1. Background

Major final amendments to the WIC Program regulations regarding food delivery systems were last published on May 28, 1982 at 47 FR 23626 in response to audits and management evaluations disclosing problems in the food delivery area which could result in loss of WIC Program funds. The May 1982 regulations have not brought about an acceptable level of improvement in vendor management. Since 1982, the Program has grown in size and complexity. The Fiscal Year 1983 appropriation for the WIC Program was approximately $1.16 billion dollars. The appropriation has grown to $3.9 billion dollars in Fiscal Year 1999. As the Program has expanded, so has the potential for loss through misuse of program funds and violation of program regulations. State agencies have responded to this need with varying levels of effort and success. Both the OIG's National Vendor Audit in 1988 and the WIC Vendor Issues Study in 1993 indicated that significant levels of vendor violations continue to persist.

In response to the National Vendor Audit, the Department published a proposed rule on December 28, 1990 at 55 FR 53446 to strengthen State agency operations in vendor management and related food delivery areas. The Department provided a 120-day comment period that closed on April 29, 1991. During the comment period, 1,066 comments were received from State and local agencies, vendors and associated groups, public interest groups, members of Congress, members of the public, and WIC participants. They indicated that significant modifications to the December 1990 proposed rulemaking were still required, and that the extent of such modifications would warrant another opportunity for public input. In addition, several members of Congress requested that the rule be proposed again in light of its potential impact on certain State agency food delivery systems.

In response to the commenters' requests, the Department's intent is to propose new food delivery regulations once more. The Department has made changes to the 1990 proposal based on suggestions of commenters and subsequent State agency vendor experiences and the 1990 Vendor Management Study, ''The WIC Files'' and the WIC Vendor Issues Study.

a. Characteristics of This Proposal

This proposal would provide State agencies with detailed design standards for effective vendor management systems, as opposed to the more generally worded requirements and emphasis on broad goals which characterize current WIC food delivery

regulations. The emphasis in current regulations on general objectives has not yielded the necessary improvements in vendor management. In March 1988, the House Surveys and Investigations Staff released a report on the WIC Program. In that report, they stated that ''knowledgeable fraud investigators believe, at a minimum, the program needs more stringent regulations and penalties to deter fraud by vendors. * * *'' In addition, in May 1988 the General Accounting Office initiated a review of efforts to minimize fraud and abuse in the WIC Program. The scope of that review includes identification of efforts that the Department of Agriculture and State and local WIC agencies are taking to detect and prevent fraud and abuse in the WIC Program. Therefore, this proposal would mandate procedures and criteria by which State agencies must manage vendors to effectively control fraud and program noncompliance. It would define critical vendor management terms; establish staffing requirements for vendor management; and strengthen vendor authorization, agreements, training, monitoring, and high-risk identification. Related food delivery areas such as food instrument disposition and security, and State agency corrective action plans are also addressed. This proposal stresses the interaction and continuity between various food delivery areas. It not only would strengthen the individual steps in the process of vendor management—selection, training, monitoring, and high-risk identification, but also would increase overall system effectiveness by meaningfully tying these steps together. It would allow State agencies as much flexibility as possible within the framework of the mandated standards to take into account the distinct individual characteristics of each State agency's management system and to facilitate further experimentation and innovation.

In addition, the proposal recognizes the emergence of technology in the retail food delivery area relative to electronic benefits transfer (EBT). An EBT system for WIC, as demonstrated in the Wyoming Pay West System, can contribute to improved accountability. Some of the vulnerabilities for fraud and program noncompliance inherent with printed food instruments can be reduced by the food-item-based type EBT system used in WIC. With an EBT system, food package benefits are issued and redeemed through a computer chip on the EBT card or a computerized account accessed with the card. The participant is issued an EBT card at the local level instead of paper checks or vouchers. The EBT card or computerized account contains the participant's Personal Identification Number (PIN) and lists the authorized supplemental foods. The PIN ensures that only the participant or proxy uses the card to obtain the authorized supplemental foods.

At the vendor, the participant selects the authorized supplemental foods just as she would if paper checks or vouchers were used. At the check-out counter, the participant enters the PIN into the Point of Sale terminal located at the counter. A proper PIN alerts the computer and the store that the participant is authorized to access the food benefits. The cashier then scans each of the selected food items. The Universal Product Code (UPC) listed on the food item is checked against the authorized supplemental foods listed in the participant's account to determine if that food item is allowable. If the computer indicates that the food item is allowable, the item is automatically subtracted from the participant's list of food items. At the same time, the vendor's bank account is automatically credited for the amount of the purchase.

Through the use of the UPC, the opportunity for overcharging, substitution, and charging for food items not received is substantially reduced in an EBT environment. If, when the food item's UPC is scanned, the computer does not accept it as an authorized supplemental food for the participant, the food item will not be accepted as part of the WIC transaction.

Another benefit of using an EBT system is greater assurance that only participants receive WIC foods. Since the proper PIN must be entered in order to initiate the transaction at the check-out counter, there is added assurance, through the computer's verification of the PIN, that the individual is a participant or her proxy.

Because EBT and scanning substantially reduce program violations both for vendors and participants, proposed section 246.12(a) would provide FNS discretion on a case-by-case basis to modify regulatory provisions which FNS determines unnecessarily duplicate the accountability capabilities inherent in the particular EBT system. In addition, this proposal would amend certain regulatory requirements to recognize the different operations of EBT. For example, proposed section 246.12(q) would be amended to clarify that a PIN rather than a redeemed food instrument may be matched to a valid issuance and enrollment record (see section 19 of this preamble); and proposed section 246.12(h)(3)(iv) would clarify that a PIN may be used in lieu of a signature on the food instrument at the time it is exchanged for authorized foods (section 12 of this preamble).

Readers should note that as part of the March 18, 1999 final rule regarding vendor sanctions (64 FR 13311), the definition of food instrument was amended to include EBT cards.

b. Comments on the December 28, 1990 Proposal

Many commenters expressed general agreement or disagreement with the Department's decision to strengthen food delivery and related areas through the rule. General supporters of the December 1990 proposal commented that it would make positive improvements in vendor management and related areas. They stated that existing State agency food delivery systems need standardization, and that much of the proposal would serve to formalize systems that exist in many State agencies. Those in general opposition to the proposal believed that it: (1) failed to take into account the diversity of State agency vendor management systems, and (2) inappropriately promoted a ''one size fits all'' approach to vendor management.

Many opponents thought that WIC food delivery regulations should continue to outline broad vendor management goals, rather than detailed standards. Commenters were concerned about the resource implications of the proposal. In particular, some State agencies felt that the proposal's requirements would overburden their administrative resources. Vendors expressed concern about the resource burden associated with the training requirement. They also commented that the proposal unfairly punished all vendors for the program noncompliance of a few, and that the current system works well for the most part, and should not be changed.

The Department acknowledges the commenters' general concerns regarding the December 1990 proposal and agrees that any standardization of State vendor management practices must take into account the current diversity and needs of existing State agency systems. In designing this current proposal, the Department has attempted to acknowledge these differences, while at the same time addressing the fundamental need for a more effective approach to State agency vendor management.

The Department still firmly believes in the need for a system of more standardized vendor management practices than currently exists.

Differences in State agency vendor management systems have resulted in inconsistent treatment of vendors across State agencies and within State agencies, as well as unacceptable levels of vendor fraud and program noncompliance. The variations in vendor management practices are significant. Some State agencies have established very specific criteria for vendor selection which allow them to authorize only the best qualified vendors by excluding those which have indicators of high risk for fraud or program error. Vendor selection criteria in other State agencies are weak and ineffective, resulting in the authorization of more vendors than are needed to adequately ensure participant access, reasonable food costs, and effective management. Some State agencies have established strong training programs for authorized vendors that require annual face-to-face contact with each vendor. Other State agencies provide no periodic training for their vendors. For these State agencies, face-to-face training is often limited to an initial authorization visit, and vendors may operate for years before they receive additional training. Some State agencies have aggressively pursued covert compliance investigations as a method of identifying abusive vendor practices. Other State agencies do not perform compliance investigations at all, or perform them only nominally.

The Department recognizes the concerns expressed by commenters that any effort toward standardization must provide State agencies with the flexibility to pursue innovation. The Department is convinced, however, that because the Program has increased in size and in complexity, standardization and strengthening of basic vendor management practices must occur in order to address current food delivery problems and ensure that the WIC Program operates effectively in the future.

Many commenters objected to the December 1990 rulemaking's emphasis on detailed design standards for vendor management versus the goal oriented standards that exist in current regulations. They stated that currently mandated regulatory standards adequately address State agency vendor management needs. It should be noted that more specific design standards for vendor management were proposed in the past. On January 23, 1981 (46 FR 7846), the Department published a proposed food delivery regulation in response to OIG audits of WIC food delivery systems conducted in 1979 and 1980. These audits identified problems with State agency food delivery systems, including deficiencies in the areas of vendor monitoring, overcharge detection, and vendor sanctions. The January 23, 1981 rule proposed a number of design standards for State agency food delivery systems including: specific selection criteria for vendor authorization; limited timeframes for vendor agreements; periodic mandatory training of all authorized vendors; and mandatory compliance investigations of a specific percentage of each State agency's authorized vendor population. Comments received on the January 23, 1981 rule expressed concerns much like those expressed almost a decade later in the December 1990 proposal: that the proposal was overly detailed, not cost-effective, and could adversely affect participants. Commenters urged the Department to outline food delivery requirements in terms of broad goals rather than specific design standards. In response, the Department dropped its detailed design proposals, and in May 1982, published a final food delivery rule which instead focused on a few carefully selected cost-effective procedures, and outlined the remaining vendor management requirements as broad State agency goals.

In the intervening sixteen years since the publication of the May 1982 final food delivery rule, State agencies have had ample opportunity to develop and implement effective systems for vendor management within the framework of the current food delivery regulations. However, the 1988 National Vendor audit and, to a lesser extent, the 1991 Vendor Issues Study, indicate that many State agencies have continued to experience the same problems identified earlier. As such, the Department must conclude that the current approach leaves much room for improvement. In light of this experience, this proposal, like the December 1990 proposal, would mandate more detailed design standards for State agency food delivery systems.

Many commenters stated that the provisions outlined in the December 1990 proposal were too resource-intensive for State agencies. The Department acknowledges that the December 1990 proposal, as well as this one, would require some State agencies to devote additional resources to vendor management, although it is possible that some State agencies could actually experience a decreased burden. Nevertheless, the need for State agencies to address problems in this area of greatest program vulnerability continues to be imperative. As with the December 1990 proposal, this rule would not propose simply to add new requirements. Rather, it would replace many current requirements with more effective procedures. For example, State agencies would no longer be required to do representative monitoring, that is, on-site monitoring visits to at least 10 percent of all authorized vendors. Instead, the Department proposes that State agencies perform either covert compliance buys or inventory audits focused on their high-risk vendors (up to 10 percent of all authorized vendors), a potentially more focused way of detecting vendor noncompliance than the current representative monitoring requirement. Compliance buys have been shown to be the most effective means of detecting and minimizing vendor noncompliance. The 1988 National Vendor audit of WIC vendor management referenced the need to require compliance buys in WIC regulations. In this report, the Inspector General stated that ''We believe that compliance purchases are the most effective method to identify that a vendor is abusing the WIC Program''. While a shift in resources may be necessary to address the proposed compliance buy and inventory audit requirements, such a shift may be accomplished by reducing their routine monitoring efforts, which frequently include annual representative monitoring visits to *all* authorized vendors. The 1996 VAMP Report indicated that out of a universe of 45,397 vendors, 51 percent received on-site monitoring visits annually.

The Department has addressed the resource concerns expressed by commenters by lessening some of the requirements proposed in the December 1990 rule. The requirement for annual face-to-face vendor training in the December 1990 proposal would be reduced to one face-to-face training session each agreement period, which could run for a time period up to 3 years. Requirements for food instrument disposition and security and many reporting requirements would also be clarified and/or reduced.

Like the December 1990 proposal, this proposal would not only establish additional specific vendor management requirements, but would also strengthen the State agencies' ability to take successful action against violative vendors, possibly reducing the long-term administrative burdens. For example, the proposed selection criteria would help to prevent the authorization of vendors with a past history of noncompliance. The proposed mandatory training would help lower the frequency of cashier errors and reduce the level of improperly redeemed food instruments. The

Department also proposes to place limits on appeal rights and procedures.

Although vendor sanctions were addressed in the December 1990 proposed rule, they are not included in this proposal. On March 18, 1999, the Department published a final rule at 64 FR 13311 establishing mandatory uniform sanctions across WIC State agencies for the most serious WIC violations, including specific WIC violations that result in disqualification from the Food Stamp Program (FSP) in addition to the WIC Program. That rule also allows State agencies to establish State agency sanctions in addition to the mandated WIC sanctions. Finally, that rule mandates the disqualification of any WIC vendor who has been disqualified from the FSP. This proposal would make a number of other changes to conform the sanction requirements to other changes proposed in this rule.

c. Comments Solicited

The Department encourages comments on this proposal and would like to know which provisions have support, as well as which cause concern. This proposal has been modified from the December 1990 proposal. Only those timely comments in response to this second proposal will be considered in the development of a final rule. Commenters are asked to indicate at the outset that they are commenting on the Food Delivery Systems rule and to cite the section number (e.g., 246.12(g)(2)(iv)) of each provision addressed. Comments prove most helpful when they are specific, stating the reasons for support or opposition, suggesting modifications which would resolve a commenter's concerns, and providing relevant background information and State agency-specific data as appropriate. Due to the inherent problems associated with the large volume of comments this rule is expected to generate, electronic transmissions, including data faxes, will not be accepted. All comments postmarked during the comment period will be carefully considered.

Specific changes are discussed in the following sections of this preamble. While provisions are generally addressed in their order of appearance in the regulatory text, considerable cross-referencing and occasional repetition have proven necessary due to the close interrelationship between areas of the vendor management and food delivery processes.

Most of the regulatory provisions relative to food delivery systems appear in section 246.12 of the regulations. The rulemaking proposes numerous significant changes to this section. The standard procedure would be to print only the proposed amendments to this section. However, each of the steps in the management process addressed in section 246.12 are thoroughly integrated. Proposed changes cannot be fully understood and meaningfully assessed except in the context of the management function to which they apply. In addition, section 246.12 has been completely reorganized. The preamble will indicate both the current cites and the new cites for changed provisions. Therefore, the Department is printing section 246.12 in its entirety. However, comments are solicited only on the substantive changes and deletions to the text; these are discussed in the preamble.

d. Impact of this proposal on affected entities

The following chart summarizes the effect of this proposal on vendors, participants and State agencies. The chart also provides an estimate of the costs and benefits associated with this proposal. It is estimated that the proposal would reduce waste, fraud and program noncompliance by 50 percent, resulting in savings of approximately $25 to $50 million. The savings would allow more participants to be served.

BILLING CODE 3410–30–P

BILLING CODE 3410-30-C

		Impact of WIC Food Delivery Proposal				
Current Rule:	Proposed Rule:	Effects On:				
		Vendors	Clients	SA's	Costs	Benefits
Summary WIC food delivery rules were last updated in 1982, and emphasize general objectives, affording States maximum discretion in selecting and managing vendors, FNS studies, management evaluations, and OIG audit findings indicate that current regulations are ineffective at preventing program abuse by vendors and clients. Therefore, more design oriented rules are proposed.	This proposal mandates procedures and criteria to strengthen State Agency management of vendors to effectively control fraud and abuse. It defines terms; establishes staffing requirements for vendor management; strengthens vendor authorizations and agreements, requires vendor training, identification of high risk vendors, monitoring, overcharge collection and detection. Also, appeals are streamlined. Participant sanctions, food instrument reviews, security of food instruments, and corrective action plans are also addressed, as is EBT.	Approximately 45,000 retail vendors are authorized to accept and redeem WIC food instruments and receive reimbursement amounting to $4 billion annually from States. The intended impact of these proposed regulations is to curtail program abuse estimated at 2% to 3% of sales annually, by increasing State oversight and eliminating abusive stores from the Program. It is anticipated that this rule will impose an additional 3 hours of burden on each vendor at an estimated average cost of $50 per year. The impacts of each provision on stores are discussed below.	Over 7.6 million women, infants and children participate in WIC and receive supplemental food, nutrition education, and health care referral. Although this data is not collected, it is estimated that less than1/2 of 1% of participants abuse WIC by engaging in trafficking and other unauthorized practices. This regulation will define mechanisms for reducing this abuse, including more severe sanctions against WIC participants who abuse the Program. The rule permits States to disqualify abusive participants up to one year with fines and sanctions levied based on the cost of foods received by the participant. However, program savings will allow several thousand additional participants to be served as a result.	The rule requires States to take more specific actions re store management, but still gives States considerable latitude. The rule will impose new requirements and offset other requirements for a net burden on 88 State Agencies. We estimate an increase reporting and recordkeeping burden on State and Local agencies to be 57,203 manhours. Using an average rate for State and local agency staff of $65, we estimate the cost of this rule for State and Local agencies would be less than $4 million per annum. States currently receive administrative grants valued at over $1.0 billion annually without a matching requirement.	Increased vendor oversight will require increased State effort. Some abusive vendors and some abusive clients will be forced off the Program, thus losing income for the vendor. Fraud in the Program also feeds political opposition to the Program. This action will not increase WIC Program costs at the Federal level.	FNS studies, audit findings, etc., show that current rules are ineffective at preventing fraud and abuse. A 1991 report found that 22 percent of authorized WIC vendors overcharge, costing the Program $39.4 million in 1991, or 1.9% of the retail redemption's in 1991. The same study also found substantial undercharges. The rule will reduce waste, fraud, and abuse by 50%, or $25 to $50 million. More recipients will be served with the money saved" through fraud reduction. The Program will operated more efficiently due to increased training at all levels. Fewer abuses will help assure continued public support for WIC.

2. Definitions (Section 246.2)

Food delivery systems vary significantly in structure from State agency to State agency. However, the discussion of issues must be based on a common understanding of key terms. In order to clarify some frequently used terms, the Department is proposing definitions for 14 terms related to vendor management.

''Authorized supplemental foods'' would be defined as those supplemental foods authorized by the State or local agency for a particular participant.

''Compliance buy'' is proposed to be defined as a covert, on-site investigation in which a representative of the Program poses as a participant, transacts one or more food instruments, and does not reveal his or her identity during the visit. This definition would exclude on-site buys used by some State agencies in which WIC staff or their agents pose as participants, purchase foods, and then introduce themselves to the vendor at the end of the transaction to discuss the results as a training mechanism.

A ''high-risk vendor'' would be defined as a vendor identified as having a high probability of violating program requirements through application of criteria mandated by the Department and any additional criteria the State agency may choose to establish. This definition would allow State agencies the flexibility to continue identifying high-risk vendors using their own criteria, in addition to the criteria that would be mandated by the Department by this rule. Criteria developed by the State agency are subject to approval by FNS through the State Plan process.

A ''home food delivery contractor'' would be defined to mean a sole proprietorship, a partnership, a cooperative association, or a corporation that contracts with a State agency to deliver authorized supplemental foods to the residences of participants under a home food delivery system. Adding this definition is necessary to accommodate the proposal to limit the term ''vendor'' to retail food delivery systems (see further discussion under the definition of ''vendor'').

This proposal would define ''inventory audit'' as an examination of food invoices or other proofs of vendor purchases to determine if the vendor purchased sufficient quantities of authorized supplemental foods to have sold the amounts of such foods to WIC participants for which the vendor has requested payment from the State agency during a given period of time. These audits are useful for identifying vendors who: buy food instruments from unauthorized vendors or from participants and submit them to the State agency for payment, without having provided to participants the quantities of authorized supplemental foods prescribed on the food instruments; and/or exchange food instruments for non-food items, or unauthorized foods.

This proposed rule would also define ''proxy'' to mean any person designated by a participant to act on her behalf and, in the case of an infant or child, the parent or caretaker who applies on behalf of the infant or child. Traditionally, proxy has been used in program regulations only to refer to a person designated by a participant to transact food instruments. This definition would make clear that when proxies are referred to in program regulations that parents and caretakers applying on behalf of infants and children are also included.

''Routine monitoring'' would mean overt, on-site monitoring during which program representatives identify themselves to vendor personnel. Such monitoring is used for technical assistance purposes.

Routine monitoring contrasts with compliance buys, which are defined as covert investigations, and with inventory audits, which entail a review of specific records. The proposed requirements for a specific number of compliance buys or inventory audits (see section 14 of this preamble) necessitates a clear distinction between these activities and all other forms of monitoring, which would be encompassed by the term ''routine monitoring.'' This term would replace the term ''representative monitoring,'' which is used in current regulations and has proven to be confusing because it implies a method for selecting vendors to be reviewed (i.e., random selection) that yields a representative sample.

The term ''vendor'' would be defined as a sole proprietorship, a partnership, a cooperative association, or a corporation operating an individual retail site authorized to provide supplemental foods to participants under a retail food delivery system. Under this definition, each individual retail site would still be considered a separate vendor. The Department proposes to use the term ''vendor'' only in retail food delivery systems. Currently, the term also applies in home food delivery and direct distribution food delivery systems. However, experience has shown that most of the vendor requirements are inappropriate in those systems. Rather than create numerous exceptions to the vendor requirements, this proposed rule would limit the use of ''vendor'' to retail food delivery systems.

Although mobile vendors can be problematic, they may be the only means to ensure services to WIC participants in outlying areas, or to homeless persons. The proposed definition would permit State agencies to authorize mobile stores when necessary to meet the special needs established in their State Plan. The definition is meant to preclude the general use of temporary food stands and trucks, or other mobile food sales operations without fixed locations, from consideration for routine authorization because their mobility makes it impracticable to monitor them adequately; because their sanitation and refrigeration capabilities are generally limited and problematic; and, because it is difficult to limit their areas of operation. State agencies must present clear rationales for the specific areas or locales proposed for mobile store service coverage in their State Plans.

The term ''vendor authorization'' would be defined as the process by which vendors who initially apply for authorization or subsequently apply for reauthorization are assessed, selected, and enter into an agreement with the State agency. This definition is proposed to clarify that the regulatory requirements for authorization apply equally to both new and reapplying vendors.

''Vendor limiting criteria'' would be defined as those criteria established by the State agency and approved by FNS as part of the State Plan process to determine the maximum number and distribution of vendors to be authorized in its jurisdiction. These criteria must be designed to result in a number and geographical distribution of authorized vendors that ensures adequate participant access, and allows for effective State agency management. Limiting criteria establish the number and distribution of vendors to be authorized and are not intended to have any bearing on which specific vendors will be authorized.

This proposal would define ''vendor overcharge'' as a pattern of intentionally or unintentionally charging participants more for authorized supplemental foods than non-WIC customers or charging more than the current shelf price or contract price. The definition would clarify that inadvertent mistakes that result in excess charges to the Program are considered overcharges; that is, the State agency would not have to establish that the vendor intended to overcharge in order to determine that this form of program noncompliance has taken place. It would also take into account

State agencies which contract for a set price for supplemental foods with vendors during the life of the agreement.

The term ''vendor selection criteria'' would be defined as the criteria mandated by the Department in section 246.12(g)(3), and any additional criteria established by the State agency and approved by FNS as part of the State Plan process, to select individual vendors for WIC authorization. Application of these criteria is meant to ensure systematic selection of only vendors who are best qualified to provide food benefits to participants in a manner consistent with the WIC Program's mission and effective program operations. While selection criteria may have the incidental effect of limiting the number of vendors who are authorized, their primary purpose is to determine the best qualified vendors, not the number, of such vendors.

''Vendor violation'' is proposed to be defined as any intentional or unintentional action of a vendor (with or without management knowledge) which violates the Program statute or regulations or State agency policies or procedures. This definition would clarify that vendors should be held accountable for violations, whether they are deliberate attempts to violate program regulations, or inadvertent errors, since both ultimately result in increased food costs and fewer participants being served. This definition clarifies that it would not be necessary for the State agency to ascertain the intent behind an action which, whether inadvertent or deliberate, has the same negative effect on the Program. The Department acknowledges that the inherent complexity of the WIC transaction is such that, even with training and supervision, cashiers may occasionally make unintentional errors. While this definition would include both intentional and unintentional actions (with or without management knowledge), this does not mean that a minor unintentional action by a cashier without management knowledge would result in disqualification. State agencies have a wide range of actions that they may take as a result of a vendor violation, including assessing a claim, requiring increased training, identifying the vendor as a high-risk vendor subject to monitoring, assessing administrative fines, and imposing a sanction.

The Department believes that a vendor is not relieved of the responsibility for an employee's continuing noncompliant actions just because the vendor's management was unaware of the violations. Allowing vendors with continuing violations to sustain their authorization by simply permitting them to remove an employee who violates program regulations would result in few disqualifications, since the claim that the violation was caused by a dishonest employee, who has since been fired, is one of the most common defenses used during vendor appeals (see ''The WIC Files''). Removing such an employee does not mitigate the effects of chronic vendor error and mismanagement on program costs, nor does it lessen the vendor's responsibility to provide effective oversight and appropriate employee training.

''WIC'' would be defined as the Special Supplemental Nutrition Program for Women, Infants and Children authorized by section 17 of the Child Nutrition Act of 1966.

3. Vendor Management Staffing (Section 246.3(e)(5))

Proposed section 246.3(e)(5) would require that State agencies which anticipate 50 or more authorized vendors as of October 1 of each fiscal year devote a full-time staff year to vendor management. State agencies would have the option of designating a single full-time vendor management specialist or to assign vendor management duties to more than one staff person, provided the total time spent on vendor management is equivalent to one staff year. The State agency would identify these positions as part of the staffing pattern already required by section 246.4(a)(4). State agencies which anticipate fewer than 50 vendors as of October 1 of each fiscal year would be required by this proposal to designate a staff person responsible for vendor management. No standards for the amount of time this person would devote to these duties are proposed in this rulemaking.

The requirements for staffing of vendor management are being proposed because, although, according to the 1990 WIC Vendor Management Study, at least 37 percent of geographical State agencies had a designated full-time vendor management position, a wide range exists in State agency staff devoted to vendor management. In some State agencies, vendor management responsibilities are not clearly assigned to specific staff, resulting in the increased possibility of vendor noncompliance due to insufficient resource allocation, imprecisely fixed management responsibility, and the lack of an expert in this highly technical area of program management. The results of the 1988 National Vendor Audit and the requirements proposed elsewhere in this rulemaking make it necessary for State agencies to focus increased attention on vendor management. The Department is, therefore, proposing this minimum vendor management staffing requirement to promote assignment of adequate resources to, as well as to assign specific responsibility for, vendor management functions, particularly among State agencies with 50 or more vendors.

4. State Plan Requirements (Section 246.4)

Section 246.4(a)(14)(ii) is proposed to be amended to require the State agency to describe its vendor limiting criteria. Limiting criteria are discussed in more detail in section 8 of this preamble. Section 246.4(a)(14)(iv) would be amended to require State agencies which choose to delegate any aspect of vendor monitoring to describe their system of quality control to ensure uniformity and quality of local agency or contractor efforts. In addition, section 246.4(a)(14)(iv) requires State agencies to include in their State Plan the criteria used to determine which vendors will receive routine monitoring visits. Section 246.4(a)(14)(vi) would be amended to require a description of the system the State agency will use to account for the disposition of food instruments, in accordance with section 246.12(q), rather than the current requirement of a description of the State agency's system for reconciliation of food instruments in section 246.14(a)(14)(vi). This change is discussed further in section 19 of the preamble.

Two paragraphs are proposed to be added to the section of the State Plan that addresses food delivery systems in recognition of the emphasis this rule would place on vendor training and food instrument security. These provisions would require descriptions of the State agency's vendor training procedures (section 246.4(a)(14)(xii) and section 12 of this preamble) and the system for ensuring the security of food instruments (section 246.4(a)(14)(xiii) and section 18 of this preamble). The provision on food instrument security would replace the current requirement concerning food instrument control in section 246.4(a)(14)(vi).

State agencies would be required by proposed section 246.4(a)(14)(xiv) to include in their State Plans a description of their criteria for making participant access findings. In addition, proposed section 246.4(a)(14)(xv) would require State agencies wishing to authorize mobile stores to include in their State Plans the special needs necessitating this action.

Finally, proposed section 246.4(a)(15) would be amended to require a description of the State agency's system to prevent and identify dual participation as required by section 246.7(l)(1)(i) and (ii), including the amendments proposed to be made to that section and discussed in section 5 of this preamble.

5. Prevention and Identification of Dual Participation (Section 246.7(l))

This rulemaking proposes to amend section 246.7(l)(1) to strengthen intra-State agency and inter-State agency dual participation detection efforts within the WIC Program, and between WIC and the Commodity Supplemental Food Program (CSFP) (7 U.S.C. 612c note), by requiring the identification of all suspected dual participants at least quarterly. In addition, in cases of dual participation resulting from intentional misrepresentations, State agencies would be required to pursue the collection of improperly obtained benefits in accordance with proposed section 246.23(c)(1). If the participant failed to make full restitution, the State agency would be required to disqualify the participant from both programs for one year in accordance with proposed section 246.12(u)(2). If full restitution is made prior to the end of the disqualification period, the State agency may permit the participant to reapply for the Program. Proposed changes to the participant claims and disqualification procedures are discussed in section 22 of this preamble.

Dual participants are persons simultaneously participating in the Program in one or more WIC clinics or persons participating in the Program and CSFP during the same period of time. The Department's Office of Inspector General recommended at least quarterly reporting after finding in the 1988 National Vendor Audit that some State agencies have inadequate systems for preventing and detecting dual participation and sometimes fail to take action against possible dual participants whom they have identified. This proposal would further strengthen integrity by requiring State agencies to work together to attempt to identify dual participation between contiguous local service areas located across State agency borders if geographical and other factors make it likely that participants travel regularly between such locations.

The Department also wishes to clarify that dual enrollment does not necessarily constitute dual participation. However, as a sound management practice, State agencies should create accountability systems to identify and correct situations in which a participant is enrolled and receiving benefits from one WIC or CSFP agency, but continues to be enrolled (but not receiving benefits) in another. Although such a participant may not technically be receiving dual benefits, the potential for dual participation exists and should be eliminated by removing the participant from one of the enrollment rosters. The Department is not addressing controls on enrollment in this proposal.

Nor does this proposal mandate that specific minimum data matching criteria be used to identify dual participants. Because the Department has limited evidence of the effectiveness of the various criteria currently used by State agencies, the Department is not mandating specific matching criteria. It seems likely, however, that social security numbers are the most effective and readily available personal identifiers. State agencies have long had authority to require social security numbers as a condition of participation, pursuant to the Tax Reform Act of 1976 (codified at section 205(c)(2)(C)(i) of the Social Security Act, 42 U.S.C. 405(c)(2)(C)(i)). The Department recommends but does not require that social security numbers be used whenever possible to identify dual participation. However, section 7(b) of the Privacy Act of 1974 (5 U.S.C. 552a note) requires that notice be given of the planned use of social security numbers by State agencies. Therefore, State agencies should consult with their State's attorneys before using social security numbers to identify dual participation.

Section 246.23(c)(2) of this proposal includes a new provision that would authorize FNS to establish a claim against State agencies when they have not complied with the requirements to identify dual participants, if the State agency has not taken steps to recover funds from or disqualify certain dual participants.

6. General Food Delivery System Requirements (Sections 246.12(a) Through 246.12(d))

The Department proposes to reorganize the food delivery system requirements in section 246.12 in recognition of the new definition of vendor that applies only in the retail food delivery system context. Under the proposal, the general requirements for food delivery systems would be grouped in section 246.12(a)–(d). The special requirements for retail food delivery systems would be in section 246.12(e)–(l), the home food delivery system requirements in section 246.12(m), the direct distribution food delivery system requirements in section 246.12(n), and the remaining general requirements in section 246.12(o)–(v). The Department is only seeking comments within Section 246.12 on those areas where substantive changes have been made. These areas include: paragraph (f) (food instrument requirements); paragraph (g) (vendor authorization); paragraph (h) (vendor agreements); paragraph (i) (vendor training); paragraph (j) (monitoring vendors and identifying high-risk vendors); paragraph (k) (vendor claims); paragraph (q) (food instrument disposition); paragraph (t) (conflict of interest); and paragraph (u) (participant violations and sanctions). The specific proposed changes within this reorganized structure follow.

As discussed in section 1.a of this preamble, proposed section 246.12(a) would be amended to give FNS the authority to modify program regulations for EBT systems. In addition, the current requirement in section 246.12(e) that only food vendors authorized by the State agency may redeem food instruments would be moved to section 246.12(b) and revised to make clear that it applies whenever food instruments are redeemed under any of the food delivery systems. Finally, proposed section 246.12(b) would make clear that each system must ensure adequate participant access to supplemental foods.

7. Retail Food Delivery Systems: Food Instrument Requirements (Section 246.12(f))

The current food instrument requirements in sections 246.12(r) that have relevance only in retail food delivery systems would be moved to section 246.12(f). Proposed section 246.12(f)(1) would make clear that food instruments must be used in retail food delivery systems. As proposed, section 246.12(f)(2) would make clear which food instrument requirements are applicable only to printed food instruments. This change is necessary in recognition of the March 18, 1999 final rule concerning vendor sanctions that amended the definition of food instruments in section 246.2 to include EBT cards.

In addition, new provisions would be added in section 246.12(f)(2)(i) and (vii) to require printed food instruments to provide: (1) a list of the supplemental foods authorized to be obtained with the food instrument, and (2) a signature space in which the participant or proxy must sign at the time the supplemental foods are obtained.

8. Vendor Limiting Criteria (Section 246.12(e)(2))

Under this proposed rule, the vendor authorization requirements currently found in section 246.12(e) would be moved to proposed section 246.12(g). In addition, the Department proposes to mandate limiting criteria as described in section 246.12(g)(2). Limiting criteria permit State agencies to authorize only a sufficient number of vendors in an area to ensure adequate participant access and effective program oversight.

There are also other benefits to implementing limiting criteria. The State agency must apply a significant amount of resources to the management of each authorized vendor. A case file must be established and data collected and entered. Each vendor must be visited on-site at initial authorization. Training would have to be provided annually, as proposed in section 246.12(i) of this rulemaking. Other costs also increase with the number of authorized vendors. Compliance buys and other forms of monitoring would have to be performed as outlined in proposed section 246.12(j). Reports must be produced and analyzed, mailings initiated, sanctions applied and tracked, and appeals held as appropriate. If the State agency authorizes more vendors than necessary to ensure adequate participant access, the administrative resources available to manage vendors may not be sufficient to ensure effective oversight, thus increasing the possibility that program noncompliance will be undetected and/or forcing curtailment of other critical State and local agency activities.

Proposed section 246.12(g)(2) mandates that the State agency establish and implement criteria to limit the number and specify the distribution of vendors to be authorized. The State agency would not be required to use specific criteria when limiting vendor numbers. It would however, be required when developing the criteria to at least consider the establishment of participant-to-vendor ratios for sub-areas of its jurisdiction based on factors such as population density, distribution of participants, location of local agencies and clinics, and availability of public transportation and road systems to the WIC population.

The vendor limiting process must balance the need to provide adequate participant access to authorized vendors and the need for a vendor population that State agencies can effectively manage given the administrative resources available to them. Weighing these concerns, State agencies might, for example, develop one or more participant-to-vendor ratios. Typically, the State agency would first establish sub-areas within its jurisdiction based on such factors as the distribution of caseload, the location of local agencies and clinics, availability of public transportation and road systems to the WIC population, and the supply of prospective WIC vendors. Each type of sub-area, in turn, would be assigned an appropriate participant to vendor ratio. Theoretically, a State agency with a highly refined methodology might assign a different ratio to each individual sub-area, but State agencies will more likely limit themselves to a small set of ratios capable of addressing the differing needs of particular areas.

Limiting criteria would be required to be implemented consistently throughout the State agency's jurisdiction, with due consideration for the varying geographic and other characteristics within the jurisdiction. The important point in establishing limiting criteria is that State agencies apply them fairly and with clear rationales throughout their jurisdictions. The State agency would be required to establish system to revise and/or reapplying its limitation criteria whenever it determines that relevant demographic shifts or significant changes in local caseload allocation, growth, or decline make such action necessary.

Most State agencies agree that limiting the number and distribution of vendors is of benefit to the Program. However, some have pointed out that the resources required to establish limiting criteria and manage the resultant appeals if a vendor is denied authorization would be overly burdensome. Moreover, many State agencies do not distinguish between limiting criteria and selection criteria. Through limiting criteria, the State agency first decides how many vendors should be authorized and where, in general terms, they should be located. Limiting criteria are applied before selection criteria. Only after these decisions have been made can the State agency apply selection criteria to determine which specific vendors will be authorized. Many State agencies believe that vendor numbers can be effectively controlled through the application of strong selection criteria. This is true. While selection criteria may have the incidental effect of limiting vendor numbers and determining vendor distribution, such criteria establish the number and distribution of vendors which is based on vendor ability to meet basic authorization qualifications rather than the need for a vendor in the area.

Many vendors believe that limiting the number and distribution of authorized vendors is anti-competitive. They feel that any vendor who meets basic authorization qualifications should be authorized. Vendors have also expressed concern that implementation of limiting criteria would not allow smaller stores to effectively compete with the larger chains for WIC authorization.

The Department does not believe that every vendor who meets basic authorization qualifications should necessarily be authorized to accept WIC food instruments. Authorization to accept WIC food instruments must be governed by the access needs of participants and the qualifications of the vendor. It must be remembered that, in a few State agencies, retail stores play little or no role in their WIC food delivery systems. Those State agencies either purchase all WIC foods through large-scale competitive procurement and distribute them directly to participants or contract with home food delivery contractors. On the other hand, the majority of State agencies deliver WIC benefits through retail stores, and their cooperation and service contribute significantly to program operations. The Department gratefully acknowledges their contributions, in exchange for which vendors benefit from the considerable volume of food purchases made through WIC in the retail marketplace, and the additional non-WIC purchases that participants often make while in the store. The Department also acknowledges the critical importance of small non-chain stores in assuring adequate participant access.

Congress established the WIC Program as a preventive nutrition and health program for pregnant women, infants and young children. The Program receives annual appropriations from Congress. WIC is not an entitlement program, with unlimited resources to accommodate changes in the economy or to serve all eligible persons. Rather, WIC's funding is discretionary, meaning it is provided a set amount of funding and can serve only as many participants as this funding allows. Hence, the Department pursues policies which enhance serving the maximum number of eligible women, infants, and children with this limited funding. Vendors are a critically important service component of the Program. They provide the foods needed by the participants and in turn receive payment for the foods.

The Department's view is that, in order to use both nutrition services and administration funds and food dollars effectively and efficiently for the benefit

of participants, the State agency must first have the right and authority to limit the number and determine the geographical distribution of vendors to be authorized in accordance with its analysis of how to ensure adequate participant access to the Program. Second, the State agency must be able to select individual vendors in a way that will promote efficient use of its food grant through both reasonable food prices and the reduced possibility of vendor noncompliance.

State agencies are reminded that they must develop and implement vendor selection and limitation criteria consistent with the anti-discrimination provisions of civil rights legislation. However, Congress has enacted legislation, Public Law 105–336, which requires that the price a vendor charges for WIC foods be a key factor in selecting a vendors for authorization. In implementing this requirement, State agencies may evaluate the food costs of small vendors on the basis of food cost among peers—other small vendors—when small vendors are vital to participant access. The use of peer group cost comparisons mitigate any negative impact on small vendors of the legislative requirement to select vendors on the basis of cost.

In summary, while any vendor may apply to be authorized as a WIC vendor, State agencies have the right and the authority to establish vendor selection and limitation criteria which ensure:

- Adequate participant access to the Program;
- Maximum usage of funds;
- Minimum possibility of vendor misuse or mismanagement of funds, or fraud;
- Consistency with civil rights legislation.

While this approach to vendor authorization may restrict the ability of a particular retail store to secure or retain WIC authorization, the Department believes that it is ultimately in the best interests of the Program.

The smaller vendors who are concerned that their authorization could be adversely affected by limiting or selection criteria should be aware that the Department does not foresee dramatic future decreases in the number of authorized smaller WIC vendors. Smaller vendors will always be needed to ensure adequate participant access, particularly in areas where there is a lack of larger chain stores and areas where the number of vendors is small and transportation is difficult. In these cases, it should be reiterated that small vendors will compete for WIC authorization on the basis of their costs relative to other small vendors serving the same area.

A number of vendors have also expressed concern that limiting criteria would adversely affect participant access. Section 246.12(b) would continue to require that all food delivery systems ensure adequate participant access and proposed section 246.12(g)(1) would require State agencies to authorize an appropriate number and distribution of vendors to ensure adequate participant access (as is currently required in section 246.12(e)(2)). Again, it is important to stress that smaller vendors are critical to the Program, and where instrumental in ensuring adequate participant access, will have equal opportunity to compete for WIC business.

As proposed in section 246.4(a)(14)(ii), the State agency's limiting criteria would be a mandatory component of the food delivery system description in its State Plan. The State agency's limitation system would be subject to public scrutiny and comment as part of the State Plan development process as is currently required by section 246.4(b). The Department believes that it is at this stage where there is an opportunity for dialogue between State agencies and their vendor communities about proposed changes to the State Plan that might affect them. While the limiting criteria themselves would not be subject to administrative review, vendors would be able to appeal a denial of authorization resulting from application of the limiting criteria. For example, where the limiting criteria provided for four vendors within a zip code area, a vendor within that zip code area could file an appeal alleging the State agency incorrectly determined it to be outside that zip code area. However, the State agency's decision to use zip code areas as the basis for the limiting criterion or the number of vendors the State agency determined to be necessary for that area would not be subject to administrative review. In most cases, though, vendor appeals will be based on the application of the selection criteria. In general, the limiting process will be irrelevant to denial of authorization of a particular vendor because it is a systematic process that establishes only the desired number of vendors and does not consider the qualifications of a specific vendor. These qualifications are considered during the selection process. Denial of an application for authorization may be appealed by a vendor.

The Department is particularly interested in receiving comments on the proposed limitation provision. Comments are most helpful when they are specific, stating the reasons for support or opposition, suggesting modifications that would resolve commenter's concerns, and providing relevant background information and State agency-specific data as appropriate.

9. Retail Food Delivery Systems: Vendor Selection Criteria (Section 246.12(g)(3))

State agency experience (see ''The WIC Files'') has shown that development and application of good vendor selection criteria during the authorization process can provide a very cost-effective method of cost containment and prevention of program noncompliance. Current regulations do not specifically address the establishment of vendor selection criteria. They only require vendors to be evaluated in connection with the biennial assessment of vendor qualifications mandated by Section 246.12(g). Selection criteria have sometimes been confused with limiting criteria, because selection criteria may have the incidental effect of limiting the number of vendors authorized. The Department wishes to reiterate that, while limiting criteria determine a specific number and distribution of vendors for an area, selection criteria determine which vendors meet basic yes/no eligibility criteria, such as adequate stock and inventory, and prices below a specified maximum amount.

The Department is proposing in section 246.12(g)(3) to require State agencies to implement six specific selection criteria. State agencies would be permitted to supplement the mandatory criteria with criteria of their own choice. Such State agency-established criteria must be approved by FNS as part of the State Plan process. The six proposed mandatory selection criteria are: (1) Competitive price; (2) minimum variety and quantity of authorized supplemental foods; (3) lack of a record of a criminal conviction or civil judgment for specified activities; (4) lack of a history of serious vendor violations; (5) lack of a history of serious FSP violations; and (6) not currently disqualified from the FSP or, if subject to a FSP civil money penalty for hardship, the period of the disqualification that otherwise would have been imposed has expired.

Competitive pricing (section 246.12(g)(3)(i)) is widely accepted as a successful cost containment mechanism, facilitating service to greater numbers of eligible participants. Section 203(l) of Public Law 105–336 now requires all State agencies to

consider, in selecting retail stores for authorization, the prices the store charges for WIC foods as compared to other stores' prices for such foods. The law further provides that State agencies must establish procedures to ensure that selected stores do not subsequently raise prices to a level that would make them ineligible for authorization.

The price criterion may consist of assessing applicants based on either their shelf prices for supplemental foods or their price bids for supplemental foods, which may be lower than their shelf prices. Dollar limits could be developed based on historical data such as average redeemed prices for food instruments or on shelf prices. The limit calculated for each food package could be a statewide average, or could vary by area and/or vendor type. For example, a State agency may decide to establish a higher competitive price in an area in which the only reasonably located stores have higher prices than the surrounding areas in order to ensure adequate participant access for that area. The stores in that area would thus not be penalized for their higher prices that may be the result of the higher costs of doing business in that area. As with all limiting and selection criteria, State agencies may not adopt criteria that will result in inadequate participant access, such as a competitive price limitation that results in an insufficient number of vendors located where participants can reasonably be expected to shop.

Proposed section 246.12(h)(3)(viii) would require that vendor agreements contain a provision limiting vendors to charging no more than the competitive price limitation. This change is necessary to comply with section 203(l) of Public Law 105–336 and to make the use of competitive price as a selection criterion effective.

State agencies would then need to have a procedure to ensure authorized vendors comply with the competitive price limitation. Such procedures could include setting a not-to-exceed limit for the food instrument (either by printing it directly on the food instrument or through a bank or system edit), collection of periodic price survey data from vendors, or surveying price data during monitoring visits.

Some vendors have commented that the ''free market'' approach in which the ''market'' dictates prices works best and that basing authorization on competitive price is exclusionary, unfair, and ''against the free enterprise system.'' Some also feel that predatory pricing of supplemental foods to gain authorization by larger stores would result in a smaller market share for smaller independent grocers. Vendors should be aware that this proposal would not result in State agencies dictating the prices for authorized supplemental foods. Competitive pricing is already used by most State agencies as a selection criterion in retail food delivery systems. Prices of authorized foods are based on the current shelf or ''market'' price that is charged to non-WIC customers. This price is established by the vendor. In home food delivery systems and some retail food delivery systems, prices are based on the lowest ''contract'' or ''bid'' price. Again, these prices are established by the vendor and based on market conditions, not WIC Program dictates. Although competitive price has been used as a selection criterion by most State agencies since the Program's inception, this has not generally resulted in a lessening of the market share for smaller independent vendors. It is important, then, to note that any vendor can improve its position in the vendor selection process by decreasing prices of its WIC-eligible foods. In addition, as mentioned earlier in the discussion of limiting criteria, smaller vendors will always continue to be authorized because they are needed to ensure adequate participant access, particularly in urban areas where large chain stores are less likely to be located, and in rural areas where transportation is difficult.

Finally, the Department has recently noticed a significant increase in the number of ''WIC-only'' stores authorized under the Program. WIC-only stores are stores which may only serve WIC participants and are sustained through their WIC business. While the free market environment allows establishment of such entities, the Department is concerned that such stores may profit through use of unreasonably high prices of the foods charged to the WIC Program. Congress has expressed its concern regarding the costs of foods under the Program by requiring all State agencies to consider price when selecting vendors. As such, the Department will pay particularly close attention to implementation of the competitive price requirement in States where ''WIC-only'' stores exist.

The second selection criterion (section 246.12(g)(3)(ii)), minimum variety and quantity of authorized supplemental foods, would require the vendor to have supplies of such foods that are adequate, as quantitatively defined by the State agency, to ensure that participants can receive the prescribed amounts and types of foods. Minimum variety requirements refer to the minimum types and brands of authorized supplemental foods, e.g., two types of milk (whole and low fat) or two types of cheese (American and Swiss), that a vendor would be required by the State agency to keep on the shelf at all times. Minimum quantity refers to keeping a minimum number of each type or brand of food, e.g., three containers for each type of milk or three packages of each type of cheese, on the shelves at all times. In addition, if the State agency mandates specific package sizes, the State agency could require that the vendor stock the required package sizes. The Department encourages State agencies to take into account the availability of various package sizes and the shelf space of the whole range of their vendors in establishing the minimum variety and quantity requirements.

The third selection criterion (section 246.12(g)(3)(iii)) is lack of a record of certain business-related criminal convictions or civil judgments, on the part of the vendor itself, or any of its current owners, officers, directors, or partners. Covered criminal convictions and civil judgments would include offenses such as fraud, violations of Federal anti-trust statutes, embezzlement, theft, forgery, and bribery.

The fourth selection criterion (section 246.12(g)(3)(iv)) would require the lack of a history of serious vendor violations during a period set by the State agency, but not less than one year and not more than six years prior to the date of application, resulting from the acts or omissions of any persons currently associated with the vendor as an owner, officer, director, or partner. If the vendor violation also resulted in one of the convictions or civil judgments specified in section 246.12(g)(3)(iii), the vendor would not be eligible for authorization as required in section 246.12(g)(3)(iii), and the six-year cap on considering past WIC history would not apply. In determining what constitutes ''serious vendor violations,'' the State agency would be required to include whether the vendor has been subject to any of the mandatory vendor sanctions established under proposed section 246.12(l)(1) (current section 246.12(k)(1)) and whether the vendor has failed to participate in the annual training required by proposed section 246.12(h)(3)(xi). These are minimum criteria. State agencies may include other violations under the heading of serious vendor violations such as failure to provide restitution to the State agency for overcharge claims, repeated failure to take requested corrective actions, failure to provide requested data or records to the State agency, failure to allow monitoring by program personnel,

and other similar violations. The State agency would also have the discretion to define how many instances of a violation constitute a ''history of'' serious vendor violations both for the mandatory and State agency-developed criteria. Some types of violations could be so serious or so blatant that one instance would warrant nonselection. For others, the State agency could require a series of repeated instances or combinations of violations before it decides nonselection is warranted. The Department would like comments on whether to make mandatory vendor sanctions imposed by another WIC State agency a mandatory criterion for nonselection.

The fifth selection criterion would mandate the lack of a history of serious FSP violations (section 246.12(g)(3)(v)). The State agency would be required to establish a period of consideration for this criterion of not less than one year and not more than six years prior to the date of application unless the FSP offense also resulted in a conviction or civil judgment outlined in section 246.12(g)(3)(iii), in which case the provisions in section 246.12(g)(3)(iii) would apply and the six-year maximum period for consideration of past FSP history would not apply. The State agency would be required to deny the application of any vendor when the vendor, or any individual who at the time of application is associated with the vendor as an owner, officer, director, or partner, has a history of serious FSP violations during the period of consideration. The State agency would be permitted to define serious FSP violations, except that such definition would be required to include withdrawal of FSP authorization for program noncompliance, a FSP disqualification which is in effect at any time during this period, or receipt of a FSP civil money penalty for hardship during this period. The Department wishes to point out that the State agency would also have the option to consider FSP violations which did not result in any of these actions. As with the fourth criterion, State agencies would also have the discretion to determine what constitutes a ''history'' of serious FSP violations.

The fourth and fifth criteria would not require that the vendor or someone associated with the vendor be the subject of a criminal conviction or civil judgment. Serious vendor violations and serious FSP violations may include actions that are documented in a monitoring visit or other review or investigation even if a conviction or judgment did not result from the investigation. The violation would have to fall within those defined by the State agency as constituting a history of serious vendor or FSP violations and the State agency would need to document the basis and defend its determination in the event the vendor decides to appeal its nonselection. The sixth criterion (section 246.12(g)(3)(vi)) would require that the vendor currently not be disqualified from the FSP or, if subject to a FSP civil money penalty for participant hardship, the period of the disqualification that would otherwise have been imposed has expired.

The third, fourth, fifth, and sixth selection criteria are intended to ensure that only vendors with business integrity are authorized to participate in the Program. Proposed section 246.12(g)(3) would make clear that State agencies do not have to create an elaborate system of background checks to identify criminal convictions, civil judgments, or WIC or FSP violations. They may rely on facts known to them and representations made by applicant vendors on the vendor application. State agencies are encouraged to make an effort to check with appropriate State and Federal authorities to ensure that a record of the specified criminal convictions, civil judgments, or WIC or FSP violations does not exist. However, they are not expected to do so on a routine basis. State agencies would be routinely expected to rely upon the applicant vendors' responses to questions regarding their records, and if a State agency had reason to doubt the veracity of such responses, the State agency would be expected to follow up on the information.

These selection criteria address the Department's growing awareness of unauthorized vendors involved in defrauding or abusing the WIC Program. During investigations, State agencies have sometimes found unauthorized vendors colluding with authorized vendors to defraud the WIC Program. For example, one or several unauthorized vendors may accept WIC food instruments at their store(s) and ''launder'' or pass them through an authorized WIC vendor in exchange for a portion of their value. These actions are unlawful and the Department believes that the responsible vendors should not only be prosecuted under Federal, State and local law, but that the violations preclude the vendor from consideration in the vendor authorization process.

Local agencies would not be excluded from providing input into the selection process. The Department recognizes that local agencies can provide the State agency with valuable input regarding areas of participant concentration, vendor reputation in the community, and the quality of service which vendors provide WIC participants. While encouraging the State agency to receive input from its local agencies during the selection process in areas the State agency considers appropriate, the Department wishes to stress that the State agency must itself have the documentation necessary to make the final decision regarding fulfillment of all selection criteria.

''The WIC Files'' indicate that high-risk vendors who are sanctioned often attempt to circumvent the sanctions by selling their stores for a nominal fee to a relative or associate who then reapplies for authorization while the persons responsible at the time of the sanctions actually maintain control of the stores and their profits. The Department believes that such vendors should not be authorized. As such, proposed section 246.12(g)(4) would prohibit authorization of a vendor if the State agency determines the store has been sold by its previous owner in an attempt to circumvent a WIC sanction. In determining whether an owner has attempted to circumvent a sanction, the State agency may consider whether the applicant store was sold to a relative by blood or marriage, or was sold for less than its fair market value. This does not mean the State agency must develop a comprehensive system for routinely tracking the fair market value and the family relationships for all vendors. The purpose of the provision is only to provide State agencies with guidelines to define ''circumvention'' of a sanction and respond accordingly.

10. Retail Food Delivery Systems: Timeframes for Accepting and Processing Vendor Applications and Collection of FSP Authorization Numbers (Sections 246.12(g)(6) and 246.12(g)(7))

The Department is proposing in section 246.12(g)(6) to allow State agencies to limit the time frames for accepting and processing vendor applications. The Department considers limiting the periods of time during which applications for authorization will be accepted and processed preferable to accepting and processing applications on a continuous basis during the entire year. Limiting periods for acceptance and processing of vendor applications allows the State agency to use staff resources during the authorization process most efficiently since training, collection of price data, and evaluation of selection criteria can be clustered for more efficient execution. These advantages far outweigh the disadvantages associated

with the delay before a vendor may apply. The Department considers that State agencies have always had the authority to limit application periods as part of their general responsibility for, and control over, vendor selection. However, data from the 1995 NAWD National Vendor Management Roundup Survey indicate that of the 75 WIC State agencies who responded, only 22 State agencies reported they accepted applications during a set time of the year.

To emphasize this authority, this proposed rule would expressly give State agencies the option of limiting their vendor authorization periods, with the condition that vendor applications must be accepted and processed at least once every three years. A State agency that chooses to exercise this option would be required in section 246.12(g)(6) to develop procedures for accepting and processing individual vendor applications outside of its established periods when it determines there would be inadequate participant access unless additional vendors are authorized.

Section 246.12(g)(7), as amended by this proposal, would also require that the State agency collect the FSP authorization number of all applicant vendors that participate in the FSP and, except when the State agency uses a competitive bidding procedure in which vendors bid on prices for authorized supplemental foods, the current shelf prices for such foods. The FSP authorization number facilitates the receipt of information on vendor history from the FSP. Although State agencies are not required to contact the FSP before authorizing vendors, the Department strongly encourages State agencies to do so and make use of this valuable information. Shelf price data provide the State agency with information it needs to establish whether the prices of authorized supplemental foods are competitive. Shelf price data can also be used by the State agency to develop and/or update its competitive price selection criteria, and to update price data used to identify overcharging.

11. Retail Food Delivery Systems: Time Limit on Vendor Agreements (Section 246.12(h)(1))

Current food delivery regulations at section 246.12(g) require that the State agency perform a review of each vendor's qualifications once every two years, but do not limit the period of the agreement. Proposed section 246.12(h)(1) would limit vendor agreements to not more than three years, and would delete the regulatory requirement for periodic reviews of vendor qualifications since fixed-period agreements would render this requirement superfluous. The Department believes that fixed period agreements enable the State agency to manage its vendor population on a periodic basis more easily and allows it to be more responsive to changing program conditions and needs than is the case with open-ended agreements. According to the 1990 Vendor Management Study, 78 percent of the geographic State agencies already authorize vendors for three years or less, making fixed-period agreements the norm. A vendor would need to reapply at the expiration of each agreement and would have to meet the selection criteria and the limiting criteria in effect at the time of reapplication.

In addition, current section 246.12(f) allows local agencies to establish agreements with vendors. Proposed section 246.12(h)(1) would require that all vendor agreements be established by the State agency. The Department believes that all vendor agreements should be executed by the State agency, rather than local agencies, to ensure consistent application of vendor authorization standards statewide. Conforming amendments would also be made to sections 246.4(a)(14)(iii) and 246.12(f) (which would be redesignated as section 246.12(h)).

12. Retail Food Delivery Systems: Vendor Agreement Specifications (Sections 246.12(h)(2) Through 246.12(h)(4))

This proposed rule would revise current section 246.12(f)(1) to make clear that State agencies may make exceptions to their standard vendor agreements only when necessary to meet unique circumstances and must document the reasons for any exception. One such legitimate reason would be adjustments to accommodate a State agency's EBT system. The proposed rule would move this requirement to section 246.12(h)(2).

The Department proposes to reorganize and modify a number of the requirements for vendor agreements. A few new provisions are proposed. The provisions that would be changed or added are discussed below in the order in which they appear in the proposed rule.

Proposed section 246.12(h)(3)(i) would make clear that vendors may accept food instruments only from participants or their proxies. This does not represent a change from current program operations.

The Department also proposes to change the provision currently at section 246.12(f)(2)(i) to address concerns raised by State agencies about problems with substitutions for supplemental foods designated on the food instrument. A sentence would be added to prohibit vendors from substituting other foods, non-food items or cash in lieu of supplemental food listed on the food instrument. The vendor would also be prohibited from giving credit, refunds, or exchanges (except for identical supplemental foods). Credit or rainchecks offered to participants are usually given because vendors have inadequate WIC food stocks on hand. Participants should not be inconvenienced by vendors who do not honor their contractual obligation to maintain adequate WIC food stocks in their stores. Ultimately, it is the participants who suffer nutritionally from an incomplete food package. In addition, many commenters expressed concern about the increased opportunity for program noncompliance when vendors allow refunds for foods purchased with WIC food instruments. The rule would permit vendors to exchange a supplemental food with an identical item. This should address instances of defective supplemental foods without compromising the nutritional benefit of the participant's food package. These revisions appear in proposed section 246.12(h)(3)(ii) and are included in this rulemaking so as to reflect longstanding WIC policy in program regulations.

This proposed rule would add a new section 246.12(h)(3)(iv) requiring that the vendor ensure the actual purchase price be entered on the food instrument prior to the signature by the participant or proxy. Many State agencies require the vendor to enter the purchase price prior to participant signature. However, a few State agencies require the participant to enter the purchase price, citing the educational value for participants. The proposed language would accommodate either situation. In addition, this provision would make clear that the provision applies to printed food instruments only. Thus, where an EBT system is used and the purchase price is scanned and entered electronically, rather than entered directly on the food instrument, the provision would not apply. Proposed section 246.12(h)(3)(iv) would also make clear a PIN may be used in EBT systems in lieu of the signature requirement.

Current section 246.12(f)(2)(ii) would be moved to section 246.12(h)(3)(viii) and would require vendors to charge State agencies no more than the price charged other customers (i.e. no surcharge may be imposed for WIC

purchases) or the current shelf price, whichever is less. Vendors subject to contract prices would be able to charge no more than the contract prices. This proposal would modify the current language to account for competitively bid vendor selection systems being used by some State agencies in which vendors are selected on the basis of specific prices they submit in response to a competitive procurement. This proposal would also make clear that in no case may the vendor charge the State agency more than the competitive price limitation.

Proposed section 246.12(h)(3)(ix) would clarify current section 246.12(f)(2)(v) concerning claims collection. Under this new section, the vendor would be required to reimburse the State agency upon demand, or have its payment from the State agency reduced, for the value of each vendor overcharge or other error. It would also allow the State agency to withhold or collect the entire redemption value of a food instrument containing an overcharge or other error, rather than just the amount of the error. Finally, it would permit the State agency to offset any amount owed by the vendor against subsequent amounts to be paid to the vendor.

Current regulations at section 246.12(f)(2)(vi) prohibit the vendor from seeking restitution from participants for food instruments not paid by the State or local agency. The Department proposes to clarify in proposed section 246.12(h)(3)(x) that the prohibition would also apply to any food instrument partially paid by the State agency and to remove the reference to the local agency in order to conform to the requirement at proposed section 246.12(h)(1) that only State agencies may enter into vendor agreements.

Current section 246.12(f)(2)(vii) requires the manager or an authorized representative of the store (such as a head cashier) to accept training on program procedures. This proposal would move this provision to section 246.12(h)(3)(xi) and modify it by requiring participation in training prior to, or at the time of, the vendor's initial authorization and at least once annually thereafter. The initial training of a new vendor would be required to take place at the site of the vendor (see proposed section 246.12(i)(1)). The proposal would also make clear that the training after the initial authorization training is to take place at a time and location designated by the State agency. However, State agencies would be required to provide vendors at least one opportunity to attend training on an alternative date and may offer additional alternative training dates. The Department encourages State agencies to be understanding of the particular scheduling limitations of vendors with small staffs when scheduling training.

The reference to ''head cashier'' would be removed and replaced by language requiring that a member of management participate in the training, because a head cashier may not be a store management official and thus may not possess the necessary authority to accept training responsibilities for the vendor. Further details on the proposed training requirements may be found in section 13 of this preamble and proposed section 246.12(i). Section 246.12(h)(3)(xi) would further require a vendor agreement provision putting the vendor on notice of the mandatory selection criterion in section 246.12(g)(3)(iv) making a history of failing to participate in the annual training a condition of authorization in the next authorization cycle.

This proposal has made one change to current section 246.12(f)(2)(ix). In proposed section 246.12(h)(3)(xiii), the term ''utilization'' of food instruments would be replaced with the term ''handling'' of food instruments as a clarification for the vendor.

The Department proposes to modify section 246.12(f)(2)(xiii) to require vendors to retain inventory records that are used for State or Federal tax reporting purposes, and other records as the State agency may require. State agencies would have the flexibility to determine both the length of time for retention of the inventory records and additional records that must be retained. Vendors would be required to allow access to these records by representatives of the State agency, the Department, and the Comptroller General of the United States for inspection and audit. Vendors must make these records available at any reasonable time and place. The requirement in current section 246.12(f)(2)(xii), concerning access to food instruments during monitoring visits, would be included in this access requirement. These changes would appear in section 246.12(h)(3)(xv).

Currently, section 246.12(f)(2)(xxiii) requires the vendor to notify the State agency when the vendor ceases operations or ownership changes and the agreement to be voided in cases of change of ownership. Strict interpretation of the current section 246.12(f)(2)(xxiii) has resulted in some State agencies treating corporate reorganizations as changes in ownership. Such an interpretation has resulted in terminating agreements with vendors that have undergone corporate reorganizations even though they did not affect the ownership of the corporation. This rule would make clear in section 246.12(h)(3)(xvii) that a change in business structure that does not result in a change in ownership would not trigger this provision. State agencies should focus on the substance of the transaction rather than the form of the transaction. The State agency should ensure that the vendor agreement is amended to reflect the change in business structure.

This rule would also require vendors to give notice of any change in a vendor's location. This notice is necessary in light of the role that location plays in vendor selection and limiting criteria.

In order to give State agencies sufficient time to analyze any change in ownership, location, or cessation of operations, this rule would require that vendors give 45 days notice in writing prior to the effective date of the change. In cases in which the change will trigger termination of the agreement, the lead time also would give State agencies time to seek a new vendor when necessary to ensure adequate participant access.

Proposed section 246.12(h)(3)(xviii) would specify that a vendor may be sanctioned for vendor violations in addition to claims collection. Such sanctions would be required to be in accordance with the State agency's sanction schedule.

The Department also proposes to add in section 246.12(h)(3)(xix) a provision notifying the vendor that the State agency will terminate the vendor's agreement if the State agency determines that a conflict of interest exists between the vendor and the WIC Program, at either the State or the local level. This change reflects the requirement at section 246.12(q) of the current regulations (redesignated as section 246.12(t) in the proposed rule) with the addition of a reference to conflicts with the State agency given their role in vendor authorization.

The current requirement in section 246.12(f)(2)(xiv) would be redesignated as section 246.12(h)(3)(xx) and amended to revise the reference to current section 246.23(d) regarding criminal penalties for program noncompliance.

Proposed section 246.12(h)(3)(xxi) would specify that WIC authorization is not a license, and that it does not convey property rights. Vendors would also be put on notice that in order to continue to be authorized beyond their current agreement periods they must reapply for authorization. Further, vendors would be notified that if a vendor has been disqualified for a

period of time less than the remaining term of its vendor agreement, participation in the WIC Program may be resumed upon completion of its disqualification period for the duration of the agreement without reapplying. If the vendor agreement expires before the vendor has served out the full disqualification period, and the vendor wishes to again participate in the Program after serving the disqualification, the vendor must apply to be authorized. In all cases, the vendor's new application would be subject to the State agency's selection and limiting criteria in effect at the time of the reapplication.

Proposed section 246.12(h)(4) would require that the State agency include the sanction schedule in the vendor agreement. The sanction schedule must be consistent with the current vendor sanction requirements, which would be redesignated as Section 246.12(l), and include both the mandatory vendor sanctions and any State agency vendor sanctions. This addition was made to consolidate several paragraphs that required that specific vendor sanction provisions be included in the vendor agreement. The Department recommends that State agencies include the sanction schedule as an addendum to the vendor agreement, so that it may be amended during the agreement period without having to amend the entire agreement.

The Department proposes a new section 246.12(h)(5) that would require State agencies to provide vendors a list of the actions subject to administrative review and a copy of the State agency's administrative review procedures. Proposed revisions to vendor appeals are discussed in section 22 of this preamble.

13. Retail Food Delivery Systems: Vendor Training (Section 246.12(i))

The December 1990 WIC Vendor Management Study indicated that training is the most frequently used non-investigative method for ensuring the integrity of the Program. ''The WIC Files,'' a summary of case studies of vendor investigations produced by the vendor managers of State agencies in the Southeast Region, found that vendor training is one of the most effective controls on vendor noncompliance that a State agency can implement.

The Department proposes in section 246.12(i) to strengthen the training requirements by requiring annual training for all vendors. Such training would be required to be face-to-face at least once during the vendor's agreement period, that is, once every three years or more frequently in State agencies using shorter agreements. The face-to-face training could be conducted at any time during the agreement period except that, in instances where a vendor is new to the WIC Program, the training would be required to be provided prior to, or at the time of, initial authorization, and at the site of the new vendor.

The face-to-face training could count towards fulfillment of the annual training requirement for all vendors. In other years of the agreement period, the annual training could, for example, consist of a training video, written material such as a handbook update, or verbal instructions relayed by audiotape.

The vendor's requirements for both annual and face-to-face training would be required to be outlined in the vendor agreement (section 246.12(h)(3)(xi)), including the stipulation that a history of noncompliance with these requirements would bar reauthorization (see proposed section 246.12(g)(3)(iv)). The vendor agreement would be required to make clear that the State agency has the sole discretion to determine the date, time, and place of all training, except that the vendor would have to be given at least one opportunity to reschedule. Vendors would be required to sign a receipt that they have received training. Training could take the form of individual or group sessions and could be conducted on the vendor's premises or at a State agency-selected location, except for the initial training, which would be required to be given at the vendor's site.

The Department believes that it is important that certain basic topics be covered in the annual training sessions, whether the training is provided face-to-face or is included in some other form of presentation, such as a film or printed material. As such, the Department is proposing in section 246.12(i)(2) that the following topics must be covered annually: the purpose of the WIC Program; the varieties of supplemental food authorized by the State agency; the minimum varieties and quantities of authorized supplemental foods that must be stocked; the procedures for transacting and submitting food instruments; the vendor sanction system; the vendor complaint process; the terms of the vendor agreement; and the State agency's claims collection procedures. The primary difference between the face-to-face training that would occur once during the agreement period and the training that would occur during each of the other years of the agreement period is how the training is delivered. The content would remain the same.

At the discretion of the State agency, section 246.12(i)(3) would permit training to be conducted by a local agency, a contractor, or a vendor representative. The State agency would be required to provide supervision and instruction to ensure the uniformity and quality of the training. Proposed section 246.4(a)(xii) would require that the oversight system be described in the State Plan.

Proposed section 246.12(i)(4) would require State agencies to document the content of the annual training, including the vendor receipts required by section 246.12(h)(3)(xi). By requiring an acknowledgment of the receipt and understanding of training, the State agency retains evidence of awareness of program rules and procedures by vendors. Thus, violative vendors cannot successfully argue during administrative reviews that they were not appropriately trained on their responsibilities.

14. Retail Food Delivery Systems: Monitoring Vendors and Identifying High-Risk Vendors (Section 246.12(j))

The 1988 National Vendor Audit, while not nationally representative, is consistent with the conclusion that current regulatory requirements for representative monitoring have not been effective in controlling program noncompliance. In addition, VAMP data and findings of the WIC Vendor Issues Study indicate the need to focus more attention on high-risk vendors. Therefore, this proposed rulemaking would shift emphasis away from the less effective representative monitoring and toward high-risk monitoring. This would concentrate resources on a subset of vendors which have been identified as having a high probability of abusing the Program and is likely to be more effective in combating program noncompliance.

As discussed in section 2 of this preamble, the term ''representative monitoring'' has proven to be misleading. It describes the method by which vendors are selected to be monitored rather than the type of monitoring actually conducted (see section 246.12(i)(2) of the current regulations). Representative, or random, selection for monitoring is intended to yield a sample of vendors that is generally representative of vendors authorized by the State agency. Because vendors are selected at random rather than targeted as potential high-risk vendors, the monitoring technique generally considered to be most appropriate is routine monitoring, i.e., overt monitoring in which WIC staff identify themselves to vendor personnel. Routine monitoring provides

the State agency with an overview of vendors statewide. It also has program noncompliance-deterrent and educational functions, and can adequately address inventory, sanitation, and processing of food instruments available on the premises for inspection. For these reasons, the Department proposes to replace the term ''representative monitoring'' with the term ''routine monitoring'' in the regulations.

Section 246.12(i)(2) of the current regulations requires that the State agency implement a system to conduct representative monitoring on at least 10 percent of its authorized vendors each year. The current section 246.12(i)(1) requires that the State agency also establish a system for identifying high-risk vendors and take effective action to follow up on vendors so identified, including monitoring, further investigation, and sanctioning, as appropriate. Current regulations do not mandate high-risk identification criteria, a specific technique for monitoring high-risk vendors, or a specific number of high-risk vendor that must be monitored. The result of these deficiencies has been uneven implementation of high-risk identification and monitoring systems with often limited effectiveness in terms of investigating high-risk vendors and taking appropriate actions based on the findings.

Given that resources available for monitoring are finite, it is more logical to concentrate on vendors with a high probability of program noncompliance than on randomly selected vendors. This is also consistent with the requirement in section 203(f) of Public Law 105–336, which requires State agencies to identify vendors that have a high probability of program noncompliance and to conduct compliance investigations of these vendors. In order to ensure effective deployment of monitoring resources for high-risk monitoring, effective high-risk criteria must be used. This proposal would help ensure that such criteria are used by State agencies by requiring them to use new high-risk criteria. Under proposed section 246.12(j)(1), State agencies would continue to be required to monitor vendors. State agencies would be permitted to delegate the monitoring to a local agency or contractor, but would be required to provide supervision and training to ensure the quality and uniformity of the monitoring.

Under this proposal, State agencies would also be required to implement high-risk vendor identification criteria specified by FNS (proposed section 246.12(j)(2)). State agencies could employ indicators of their own choice in addition to those required by FNS, and this is highly recommended. Such State-established criteria would be subject to FNS approval through the State Plan process, and such approval would involve a review of the civil rights implications of the criteria.

Much has been learned over the years about high-risk vendor identification through innovation and experimentation by State agencies; two studies, (the WIC State Agency Guide to Vendor Monitoring and the Applied Research on Vendor Abuse); the investigative activities of the Office of Inspector General in connection with the National Vendor Audit; and the data reported by State agencies through the VAMP system. While much remains to be learned about high-risk vendor identification, it is now possible to specify some basic criteria that are strongly associated with documented vendor noncompliance. For example, a vendor may routinely submit food instruments at or around their maximum possible dollar value, or at the same set value for every food instrument. Given the variation in the types and brands of authorized supplemental foods that a participant may choose, a small or no cost variation among a vendor's food instrument claims signals a possible problem meriting further review. Indicators used in the WIC Program to detect potentially high-risk vendors may not violate civil rights laws by classifying vendors as potentially high-risk solely on the basis of their minority status.

Section 246.12(j)(2) of this proposal establishes FNS's authority to mandate minimum criteria. However, the criteria themselves would not be included in the regulations. Public disclosure of the high-risk criteria would undermine their usefulness in identifying high-risk vendors and would interfere with timely changes to the criteria as knowledge about the effectiveness of various criteria increases. This flexibility also ensures that State agencies are not required to use criteria that subsequent analysis reveals to be ineffective or obsolete. The Department will inform the State agencies of changes in the minimum mandated high-risk criteria through its announcement of requirements for the annual summary of the results of vendor monitoring, which has been mandated by the WIC Program regulations since 1982 and would continue to be required by section 246.12(j)(4).

While there is a need for flexibility in establishing criteria to be used as part of high-risk identification systems, the Department also recognizes the State agencies' operational need for a certain level of stability in required high-risk identification criteria. Changes in criteria inevitably require modification of data collection procedures and management information systems. Therefore, the required criteria would not be changed more frequently than once every two years, and State agencies would be informed one year in advance of all such changes. The Department does not envision a proliferation of mandatory criteria over time or the frequent replacement of criteria. The more likely event is greater specificity in established criteria as experience indicates how they can be most effectively employed.

The Department wishes to stress that the mandated criteria would represent the minimum number of criteria a State agency must utilize in its high-risk identification system. State agencies would continue to have flexibility to use criteria which they have found to be effective in addition to those criteria established by the Department.

In this proposal, State agencies would be required by section 246.12(j)(3)(i) to annually conduct compliance buys or inventory audits on at least 10 percent of the number of vendors authorized by the State agency as of October 1 of each fiscal year. The number would not need to be adjusted based on fluctuations in the vendor population during the fiscal year. State agencies would be required to conduct buys or audits for all high-risk vendors up to the 10 percent minimum. Under proposed section 246.12(j)(3)(i), a State agency would be allowed to waive the investigation of a high-risk vendor if it documents that the vendor is under investigation by a Federal, State, or local enforcement agency or that another compelling reason based on good program management exists for not conducting a compliance buy or inventory audit. This would include investigations by the Department's Office of Inspector General and FSP investigations by FNS, but not a routine action like a health inspection.

If fewer than 10 percent of the State agency's total vendor population is identified as high-risk and are not exempted from monitoring, section 246.12(j)(3)(ii) would require the difference to be made up with vendors not so identified. These vendors would have to be selected at random as a means of testing the effectiveness of the State agency's high-risk identification system. Random selection also should result in a cross-section of all vendors being reviewed, thereby precluding a disparate over-selection of small and

minority-owned vendors. Conducting compliance buys or inventory audits on the population the State agency has identified as high-risk should result in detection of a higher percentage of violative vendors than those performed on a random sample of the entire vendor population. If the random sample and the high-risk population yield similar percentages of violative vendors and the State agency has used a large enough random sample to be statistically valid, the State agency should reassess its high-risk detection system.

When more than 10 percent of the total vendor population has been identified as high-risk, section 246.12(j)(3)(iii) would require the State agency that elects not to exceed the 10 percent minimum to prioritize vendors in order to review those with the greatest potential for program noncompliance and loss. Factors such as degree of risk of program noncompliance (e.g., point systems), location of the vendor relative to other high-risk vendors and likelihood of successful buys or audits based on past experience could be considered in establishing priorities.

The Department chose not to propose that compliance buys or inventory audits be performed on all high-risk vendors. Since high-risk identifiers can be manipulated, the high-risk identification process could be driven by the objective of minimizing compliance buy and audit activity rather than the need to identify vendors with a high probability of program noncompliance. Conversely, the identification of too many vendors as high-risk could impose an unreasonable monitoring burden on the State agency. Finally, as the WIC Program continues to grow, so will the need for compliance monitoring and accountability. Given these facts, the Department chose to propose that State agencies conduct compliance buys on at least 10 percent of their vendors. The 10 percent requirement ensures a minimum presence each year of monitoring staff as a means of deterrence, as well as detection, of program violations. When the use of percentages in setting minimum requirements for compliance buys and inventory audits results in fractional numbers, State agencies should round upward to the nearest whole number.

This proposal would no longer require State agencies to conduct any routine monitoring (currently set at a minimum of 10 percent of authorized vendors annually). The Department strongly recommends that State agencies continue to conduct routine monitoring to the extent that resources permit, but recognizes that the routine monitoring requirement must be relaxed so that State agencies can shift resources as necessary to meet the proposed high-risk monitoring requirements.

VAMP data show that one-buy investigations are not generally successful in revealing program violations such as overcharging, and that State agencies that conduct, on average, three or more compliance buys per vendor are much more likely to find occurrences of overcharging. Therefore, the Department also proposes a new requirement in section 246.12(j)(3)(i) of this rule. For investigations of high-risk vendors which result in negative compliance buys (i.e. buys in which no violations occur), the State agency would be allowed to close the investigation only after three negative compliance buys have occurred within a 12-month period. These negative compliance buys would not have to be consecutive in order for the State agency to close the investigation. For instance, the first buy could be negative, the second positive, and the third and fourth negative, which would lead to closing the investigation. Investigations containing a mix of positive and negative buys could be closed by the State agency after the third negative buy if the State agency determines that the number of positive buys was not sufficient to provide evidence of program noncompliance. An investigation of a high-risk vendor would also be considered to be complete when the State agency determines that: a sufficient number of buys has been conducted to provide evidence of program noncompliance or when an inventory audit has been completed. Investigations on randomly selected vendors would be considered complete when the State agency determines there is sufficient evidence to conclude whether the vendor is in compliance with program requirements.

Proposed section 246.12(j)(5) would establish documentation requirements for monitoring visits, including compliance buys, inventory audits, and routine monitoring visits. These are: the vendor's name and address; the date of the visit; the name(s) and signature(s) of the reviewer(s); the nature of the problem(s) detected or the observation that the vendor appears to be in compliance with program requirements. For compliance buys, State agencies would also be required to document: the date of the buy; a description of the cashier involved in each transaction; the types and quantities of items purchased; and, if available, the shelf price or contract price, and the price charged for each item purchased; and the final disposition of all items as either destroyed, donated, provided to other authorities, or kept as evidence. Recognizing that shelf prices or contract prices are sometimes difficult to obtain during a compliance buy, proposed section 246.12(j)(5) would permit the collection of shelf price or contract price data before or after the compliance buy visit. State agencies are encouraged, however, to collect shelf prices the same day as the compliance buy whenever possible to ensure that the State agency cannot be challenged during an administrative review that the prices are not truly reflective of shelf prices on the day of the compliance buy. This defense has been used by vendors during previous administrative reviews (see ''The WIC Files'').

The current requirement in section 246.12(i)(4) of documenting how the vendor plans to correct any detected deficiencies would be dropped. The Department believes that the requirements that State agencies assess claims and sanction vendors when appropriate adequately address the need to follow up on deficiencies noted in monitoring visits and that to require documentation of the follow-up in the monitoring report is duplicative and unnecessary. However, since the report will form the basis for any sanction, it is important that the report clearly document any deficiencies found. Thus, this proposed rule would retain that requirement.

a. Compliance Buy Techniques

Compliance buys are usually the best method of high-risk monitoring because they can identify and document a broad range of major program noncompliance. The fact that the program noncompliance is identified on-site and witnessed by the compliance monitor provides a strong case which can withstand the challenges of vendor appeal. As discussed in section 2 of this preamble, a compliance buy is an undercover visit to a vendor in which a person acting on behalf of the Program poses as a WIC participant and transacts food instruments in order to determine whether program noncompliance is taking place. The rationale and methodology for different types of compliance buys are outlined in the WIC Compliance Handbook issued in June, 1985. The most common type of buy is a ''safe buy,'' in which only allowed foods, either in the authorized quantities or in lesser quantities, are purchased. Once the food instrument is redeemed by the vendor, it is reviewed to see if the vendor has made the appropriate charge, based on the foods actually purchased and their prices.

In other types of buys, the buyer might, for example, attempt to purchase an ineligible food, purchase a non-food item, purchase less than the full food package, exchange food instruments for credit, or sell food instruments at a discount, i.e. trafficking.

The State agency must decide what type(s) of compliance buys to employ. As stated above, in order for the State agency to conclude that a high-risk vendor is in compliance with program requirements, proposed regulations at section 246.12(j)(3)(i) would require three negative buys. However, it would be up to the State agency to decide how many positive buys must be conducted before instituting administrative action against the vendor, except in situations where one incidence of the violation (i.e. trafficking or the sale of alcohol or tobacco products) triggers a mandatory sanction.

b. Inventory Audit Techniques

The inventory audit is a method for identifying program noncompliance in which a vendor's records of foods purchased for a set period of time, such as food invoices or receipts, are examined and compared to the amount of the same foods for which the WIC Program paid the vendor for that same period of time. Proposed section 246.12(k)(3) would require claims to be assessed when vendor violations are identified as a result of an inventory audit or other review. In addition, the March 18 vendor sanction rule requires State agencies to disqualify vendors for a pattern of claiming reimbursement for the sale of an amount of a specific supplemental food item which exceeds the store's documented inventory of that supplemental food item for a specific period of time.

Inventory audits are usually more expensive to perform than compliance buys because they require staff with a higher level of training, and because the volume of information which must be reviewed in order to establish a claim may require considerably more time. Data from the 1996 VAMP report reveal that 15 State agencies conducted inventory audits during Fiscal Year 1996. These audits are useful for obtaining evidence against suspected vendors who traffic in food instruments, or otherwise request reimbursement for more food than inventory records can support, and who are not susceptible to compliance buys because they have a small clientele and will only commit violations with known customers. As a result, the Department expects inventory audits to be used in limited circumstances.

c. Workload Implications

The proposed requirement for compliance buys and inventory audits exceeds the level of compliance buys currently conducted by a number of State agencies. The Department further acknowledges that replacement of the current requirement for 10 percent representative monitoring plus an unspecified level of high-risk monitoring with the proposed 10 percent targeted monitoring requirement may not be an even exchange since both compliance buys (given the probable need for more than one at each vendor) and inventory audits are almost always more expensive than routine monitoring visits. Data from the 1996 VAMP report indicate that 33 percent of State agencies annually conducted routine monitoring at 100 percent of their authorized vendors. For some State agencies, such visits would appear to be of questionable value when compared to high-risk monitoring. The considerable resources which extensive routine monitoring consume could be focused much more effectively on the conduct of compliance buys and inventory audits. It should also be noted that some State agencies currently exceed the proposed 10 percent requirement, thus indicating that it can be met within current and anticipated levels of State administrative funding.

15. Retail Food Delivery Systems: Vendor Claims (Section 246.12(k))

Current regulations at section 246.12(r)(5) require that the State agency establish procedures to ensure the propriety of redeemed food instruments. They require the State agency to design and implement a system of food instrument review to detect suspected overcharges and to identify vendors with high levels of suspected overcharges. The 1988 National Vendor Audit demonstrated that these general regulatory requirements have been ineffective in detecting overcharges in some State agencies. Furthermore, current regulations do not explicitly require, and some State agencies do not always take, effective follow-up action on suspected and documented overcharges. The 1991 Vendor Issues Study both accounted for over $39 million in vendor overcharges and found a close correlation between overcharging and other program violations. Consequently, the Department proposes to strengthen State agencies' general approach to overcharges.

Two basic types of overcharge detection systems are currently in operation. Price-based systems use vendors' shelf or contract prices to develop edit levels that are applied to redeemed food instruments. Redemption-based systems use edit limits derived from the value of redeemed food instruments. Both systems can be designed in a number of different ways. Given the potential for significant variation in each type of system, it is not possible to make meaningful, practical comparisons between the two types, or to argue that one type will always and unconditionally be better than all varieties of the other.

Redemption-based systems are used by more State agencies than price-based systems. The quality of redemption-based systems varies significantly according to such factors as whether and how the State agency establishes vendor peer groups in order to develop a statistical methodology sensitive to differences in redemption levels between peer groups; the tolerance levels that the State agency includes in its analysis in order to minimize the incidence of flagged food instruments that do not, in fact, include overcharges; and, the frequency with which its statistical tolerances are updated. Price-based systems also differ qualitatively according to how they address a number of variables. Because of the complexity and variability inherent in such systems, the Department believes that it would not be appropriate to attempt to govern them at this time through the regulatory process. Rather, State agencies can expect the effectiveness of whatever system they choose to be subjected to greater scrutiny by FNS Regional Offices in the future as part of their review of State Plans and management evaluations. Improvement in these systems can best be pursued through careful assessment of each individual system.

The Department does, however, propose through regulation to strengthen State agencies' general approach to overcharges. First, the Department proposes at section 246.12(k)(1) to require that State agencies develop and implement a system to identify overcharges and other errors on redeemed food instruments at least quarterly. That section would also list the other types of errors the State agency's system must detect.

Proposed section 246.12(k)(2) would confirm the State agency's authority to withhold or collect from vendors the entire redemption value of food instruments that include an overcharge, as opposed to the current practice in some State agencies of denying payment for, or collecting, only the amount of the overcharge itself. A parallel provision

would be required to be contained in the vendor agreement by proposed section 246.12(h)(3)(ix).

Proposed section 246.12(k)(4) would require State agencies to initiate collection actions within 90 days of the date of detection of an overcharge or other error. The Department believes that timely claims assessment and collection will provide an incentive for vendors to correct problems within their organization in a more timely manner. While State agencies have a number of options in pursuing vendor claims, the Department encourages State agencies to exercise their authority to demand repayment of the entire redeemed value of each food instrument containing an overcharge or other error, to offset claims when possible, and to sanction vendors for chronic violations or for failure to pay claims without sufficient justification. These actions can act as powerful deterrents to overcharging.

16. Retail Food Delivery Systems: Vendor Sanctions (Section 246.12(l))

As discussed earlier in this preamble, on March 18, 1999, the Department published a final rule amending the vendor sanction provisions. Among other things, that rule establishes mandatory disqualification periods for certain vendor violations and requires any vendor disqualified from the FSP to be disqualified from WIC, unless such disqualification would result in inadequate participant access. That rule also establishes a formula for calculating civil money penalties in lieu of disqualification. These changes are reflected in the text of this rule for reference only.

Vendor and participant sanctions are currently addressed in section 246.12(k). This proposed rule would split these requirements into different paragraphs for clarity: Section 246.12(l) for vendor sanctions and section 246.12(u) for participant sanctions. Except for the deletion of the participant sanctions section, proposed section 246.12(l) is only a redesignation, with no substantive changes, from section 246.12(k) as it appeared in the March 18 final rule. Prior to the publication of the final rule, the Department published a proposed rule on April 20, 1998, which provided the public with a 90-day comment period on the provisions in current 246.12(k). Consequently, the Department will not consider any comments at this time on proposed section 246.12(l).

17. Home Food Delivery Systems and Direct Distribution Food Delivery Systems (Sections 246.2, 246.12(m), 246.12(n), 246.12(o), and 246.12(s))

The requirements for home food delivery and direct distribution food delivery systems currently found at section 246.12(s) and (t) would be moved to section 246.12(m) and (n). Both sections would be amended to delete the requirements concerning food instruments. The food instrument requirements that would apply to all food delivery systems have been grouped together in sections 246.12(p), (q), and (r); the current requirement for uniform food instruments continues to be found at section 246.12(b). The Department recognizes that food instruments are not used in all home food delivery and direct distribution food delivery systems. The food instrument provisions only apply to those food delivery systems using food instruments.

Finally, the current requirement for participant and vendor complaints (section 246.12(j)) and prompt payment of vendors (section 246.12(m)) would be moved to sections 246.12(o) and (s), respectively, and references would be added to home food delivery contractors.

18. Food Instrument Security (Section 246.12(p))

The 1988 National Vendor Audit and management evaluations indicate that some local agencies fail to maintain adequate security for food instruments received from the State agency and fail to track the food instruments they distribute to clinics. Both of these problems increase the chance of theft and misuse. Examples of the kind of misuse that can occur are provided in ''The WIC Files.'' These include employee fraud and collusion. The Department believes that local agencies and clinics must take appropriate measures to keep food instruments (whether manual or computer-generated, and including on-line check stock or EBT cards) secure. In response to this concern, the Department is proposing to strengthen the current requirement at section 246.12(l) that State agencies control and provide accountability for the receipt and issuance of food instruments. Proposed section 246.12(p) would require the State agency to develop minimum standards for ensuring the security of food instruments, including: maintenance by the local agency of a perpetual inventory recording receipt of food instruments from the State agency and, if applicable, distribution to clinics; monthly physical inventory of food instruments on hand by the local agency and, if applicable, by clinics; reconciliation of perpetual and physical inventories of food instruments; and maintenance of all such food instruments under lock and key by the local agency and clinic, except for supplies needed for immediate use. State agencies should also be mindful of the various security risks associated with data files, such as fabrication of records and food instruments. The reference to the control of supplemental foods would be dropped as this is already covered in current section 246.12(t) (proposed section 246.12(n)).

19. Food Instrument Disposition (Sections 246.12(q), 246.13(h), and 246.23(a)(4))

Current regulations at section 246.12(n) require State agencies to identify disposition of all food instruments as validly redeemed, lost or stolen, expired, duplicate, voided, or not matching issuance records. State agencies are also required to be able to demonstrate the capability to match redeemed food instruments with valid certification records. As the 1988 National Vendor Audit observed, State agencies do not always attempt to account for all redeemed food instruments, and they sometimes fail to take effective follow-up action on instruments found not to have been validly redeemed. The reconciliation process as established in section 246.12(n) is itself deficient because it does not require that the accountability loop be completed by determining that all redeemed food instruments are supported by a valid certification record. This section also refers to ''reconciliation of each food instrument issued with food instruments redeemed and adjustment of previously reported financial obligations to account for actual redemptions and other changes in the status of food instruments.'' Finally, the term ''reconciliation'' itself has been the source of confusion among State agencies.

First, these provisions would be moved to section 246.12(q) and the term ''reconciliation'' would be replaced by the more general phrase ''accounting for the disposition of,'' which is generally applicable to all of the activities addressed in this paragraph of the regulations. State agencies would continue to be required to account for the disposition of all food instruments as either issued or voided, and as redeemed or unredeemed. The first two categories would allow the State agency to identify which food instruments are paid or deobligated. Instead of the

current requirement in section 246.12(n) that obligations be adjusted to account for actual redemptions, subsection (h) of the financial management system requirements in proposed section 246.13 would be amended to require the State agency to adjust projected expenditures to account for redeemed food instruments and other changes. The current food instrument reconciliation requirement in section 246.13(h) would be removed as duplicative. Second, proposed section 246.12(q) would require State agencies to match redeemed food instruments not only against issuance information, but also against a current masterfile of enrolled persons. Typically, the food instrument would contain a unique serial number, as currently required, and a participant identification number. A successful identification of the disposition of all food instruments would entail matching these numbers on the redeemed food instrument with their counterparts in the issuance report or file, and matching the participant identification number on the food instrument against the enrollment master file. Achieving a complete accounting for all food instruments is not expected to require State agencies to radically alter their current structure of reports. For most State agencies, it is the enrollee's certification record which triggers the production of each enrollee's food instruments and an issuance record. Other State agencies may find it necessary to reprogram their systems in order to link certification or enrollment records with food instrument issuance and redemption. In an EBT system, the PIN encoded on the card would be required to be linked to the issuance and enrollment record to indicate that a redemption was valid. Merely having the ''capability to reconcile'' redeemed food instruments against valid certifications, as current rules at section 246.12(n)(2) require, does not provide an adequate level of accountability. The Department believes that this final step must actually be carried out.

In the past, some State agencies that do not attempt to account for the disposition of all redeemed food instruments have misinterpreted section 246.23(a)(4) in the current regulations, which allows the reconciliation process to be considered complete when ''all reasonable efforts have been devoted to reconciliation and 99 percent or more of the food instruments have been accounted for.'' This language has incorrectly been interpreted to mean that State agencies may stop their reconciliation efforts when they have reached the 99-percent level. The current regulatory language was meant only to acknowledge that accounting for 100 percent of redeemed food instruments may not be possible due to such factors as mutilation of food instruments and coding errors. The Department wishes to stress that State agencies' efforts to account for the disposition of food instruments have never been considered complete when 99 percent of food instruments had been accounted for through reconciliation. State agencies are expected to account for the disposition of 100 percent of their food instruments utilizing all reasonable management efforts. Therefore, proposed section 246.23(a)(4) would both continue to assert FNS's intention to establish claims against a State agency for *all* food instruments which have not been accounted for.

In order to account for all food instruments, the State agency would be required in proposed section 246.12(q) to identify food instruments as either issued or voided, and as either redeemed or unredeemed. Redeemed food instruments would be required to be identified as validly issued, lost, stolen, expired, duplicate, or not matching valid issuance and enrollment records. FNS would consider the process of accounting for the disposition of food instruments complete *only if* the State agency can demonstrate that *all reasonable management efforts have been made to account for the disposition of 100 percent of its food instruments.*

State agencies should be aware that FNS will carefully scrutinize their efforts to identify the disposition of food instruments and will establish a claim against any State agency, pursuant to section 246.23(a)(4), which has not accounted for the disposition of all redeemed food instruments, including appropriate follow-up action on food instruments that cannot be matched against valid issuance or certification records, unless the State agency can demonstrate that it has: made every reasonable effort to meet this requirement; has identified the reasons for its inability to account for the disposition of each redeemed food instrument; and, to the extent considered necessary by FNS, has undertaken appropriate actions to improve its procedures.

20. Issuance of Food Instruments and Supplemental Foods (Section 246.12(r))

Proposed section 246.12(r) would consolidate the existing provisions in Sections 246.12 (o), (p), (r)(7), and (r)(8) concerning the issuance of food instruments and supplemental foods. The only change would be to add a reference to supplemental foods in the requirement that no more than a three-month supply of food instruments may be issued to any participant at one time.

21. Conflict of Interest (Section 246.12(t))

Current regulations at section 246.12(q) require only that the State agency ensure the absence of conflict of interest between any local agency and the vendor(s) under the local agency's jurisdiction. Section 246.12(t) of this proposal would also require the absence of conflict of interest between the State agency and any vendor. Reference to the State agency would be added in recognition of the pivotal role the State agency plays in authorizing and monitoring vendors. While the State procurement rules governing home food delivery contracts likely include conflict of interest provisions, this provision would make explicit the conflict of interest prohibition for home food delivery contractors.

In this context, a conflict of interest is generally where an individual employed by the State agency or local agency has an interest in a vendor. The interest may be financial, may relate to past, current, or future employment with the vendor, or may arise from a family relationship. Such circumstances create, at minimum, the appearance or potential that the employee's official actions on behalf of the WIC Program will be improperly influenced by the interest in the vendor. This discussion is provided for guidance purposes, and is in no way exclusive. The Department believes that this is an area which is based more appropriately on State laws or regulations governing conflict of interest.

22. Participant Violations and Sanctions (Section 246.12(u)) and Claims Against Participants (Section 246.23(c))

Participant sanctions are currently found in section 246.12(k)(9) and would be moved to section 246.12(u)(2). The Department proposes to increase the maximum disqualification period for participant violations from 3 months to 1 year and to consider actions by proxies as participant violations. Current regulations require that State agencies establish a maximum disqualification period of 3 months for participants. Many State agencies believe this maximum is ineffective in deterring participant program noncompliance. In addition, the current regulations do not address program noncompliance by proxies. Some forms of participant violations require

collusion on the part of the proxy (which may include a parent, a caretaker, or another person designated to accept and redeem food instruments—see the discussion of the proposed definition of proxy in section 2 of this preamble). Examples of this kind of collusion are given in ''The WIC Files.''

The Department acknowledges that some may view the proposed 1-year maximum as contrary to program goals because it could adversely affect the health of participants. However, the Department wishes to point out violative participants and proxies subvert the purpose of the Program so that it cannot achieve its objectives. Since WIC benefits diverted to other purposes do not benefit participants in the intended way, a longer disqualification cannot be expected to have additional serious negative consequences on a participant's nutritional status than continued program noncompliance would have. This is regrettably true whether the program noncompliance is by the participant (e.g., a pregnant woman trafficking food instruments), the participant's parent or caretaker in the case of an infant or child, or another type of proxy. WIC funds are better spent on participants whose health and well-being can be improved through the Program.

The Department is also proposing to expand the list of participant violations in current section 246.12(k)(9) to include dual participation (now section 246.12(u)(1)). Dual participation, as defined in section 246.2 entails ''simultaneous participation in the Program in one or more than one WIC clinic, or participation in the Program and in the Commodity Supplemental Food Program (CSFP) during the same period of time.'' Dual participation is discussed in more detail in section 5 of this preamble.

Section 17(f)(14) of the Child Nutrition Act (42 U.S.C. 1786(f)(14)) requires the State agency to recover the value of benefits provided to participants who have defrauded the Program to the extent that recovery is cost-effective. This mandate is implemented in section 246.23(c) of current regulations. However, the limit on participant disqualifications, be it the current three months or the proposed year, may hinder the State agencies' collection efforts because a person who subsequently becomes eligible may reenter the Program after having been disqualified for improper receipt of benefits without first making restitution. Proposed section 246.12(u)(2) would require State agencies to disqualify participants for one year in cases where a participant violation gives rise to a claim. In recognition of the hardship that such a disqualification could place on an infant or child participant, who could not have committed the violation, the proposed rule would require the State agency to permit another proxy to be designated before disqualifying an infant or child participant. In addition, under the proposal, the State agency could permit a disqualified participant to reapply if full restitution is made prior to the end of the disqualification period.

The Department wishes to clarify the difference between a participant sanction and a participant claim. A participant sanction is an administrative action taken in response to program violations in order to protect the integrity of the Program. A participant claim is an assessment of financial liability for the value of improperly obtained program benefits. This proposal would also revise section 246.23(c)(1) to require State agencies in all cases to send a letter to the participant requesting payment for improperly obtained program benefits and indicating that, if the request for repayment is not appealed or is unsuccessfully appealed, the participant must be disqualified for one year, unless the participant is an infant or child for whom an alternate proxy acceptable to the State agency is found. If full restitution is made prior to the end of the disqualification period, the State agency would be allowed to permit the participant to reapply for the Program. If the participant fails to make payment in response to this letter, the State agency would be required to assess the cost-effectiveness of each additional step in the collection process against the value of the benefits involved and to take such actions until the recovery process ceases to be cost-effective. To help facilitate resolution of such claims, the Department proposes to permit State agencies to allow participants for whom financial restitution would cause undue hardship to perform in-kind service, determined by the State agency, in lieu of monetary repayment. While the Department acknowledges that collection efforts could in many instances prove prohibitively expensive, it believes that at least an initial, low-cost effort would always be cost-effective. This paragraph would continue to permit the State agency to delegate the responsibility for the collection of participant claims to the local agency, though it would be moved to proposed section 246.23(c)(3).

23. Vendor Appeals (Section 246.18)

Current regulations at section 246.18 establish minimum requirements for vendor and local agency appeal rights and State agency administrative review procedures. The procedural requirements are intended to establish a simple and fair appeal process at a reasonable cost to State agencies. Some State agencies have significantly exceeded the regulatory procedural requirements, for example, by requiring that the decision makers be administrative law judges and providing for a verbatim transcription of their administrative review proceedings. In response to this situation, the Department's Office of Inspector General recommended in the 1988 National Vendor Audit that the Department mandate standard administrative review procedures in order to limit costs. This would prevent State agencies from exceeding the minimum procedures required by the current regulations. The Department continues to believe that the procedures mandated by program regulations are adequate. While the Department is not proposing to prohibit the use of more elaborate procedures, the Department does not consider such procedures to be an effective use of the limited nutrition services and administrative funds and encourages State agencies to develop administrative review procedures that stick to the minimum requirements in this section.

To support State agency efforts to control appeal costs, make the process more manageable, and ensure fairness to vendors, the Department is proposing to: (1) Limit the types of State agency actions subject to administrative review; (2) establish abbreviated administrative review procedures for certain adverse actions; and (3) relax review procedure timeframes.

Current regulations at section 246.18(a)(1) allow vendors and local agencies to appeal a denial of an application for authorization, a disqualification from the Program, and ''any other adverse action which affects participation.'' The Department considers the phrase ''any other adverse action which affects participation'' to be inappropriate for vendor appeals. A vendor could, for example, seek to appeal a State agency decision to authorize another vendor in the area on the grounds that the action would reduce the first vendor's volume of WIC business. In situations such as this, the State agency's responsibility is to ensure adequate participant access to the Program, not to protect the individual interests of a vendor. Thus, the

Department proposes to limit the State agency actions that are subject to administrative review. Except in certain circumstances discussed herein, these actions include: (1) A denial of authorization based on selection criteria or the State agency's determination in accordance with proposed section 246.12(g)(4) that the vendor is attempting to circumvent a sanction, (2) a termination of an agreement for cause, (3) a disqualification, and (4) the imposition of a fine or a civil money penalty in lieu of disqualification. Vendors that believe their civil rights have been violated in the authorization process may file complaints under the authority of civil rights legislation.

Questions have also arisen about whether fines imposed by courts may be appealed to the State agency. Only those actions taken by the State agency are subject to administrative review by the State agency. Thus, any sentence or civil judgment imposed by a court may only be pursued in the courts. Conversely, fines or civil money penalties in lieu of disqualification imposed by a State agency are subject to review by the State agency.

Readers should note, however, that to the extent that the amount of a fine or civil money penalty is precisely set in the State agency's sanction schedule, the decision maker would not have the authority to alter the amount of the fine or civil money penalty on appeal unless the decision maker found that either it had been incorrectly calculated or the vendor did not commit the cited violation.

Proposed section 246.18(a)(1)(ii) would list the adverse actions that would receive an abbreviated administrative review: (1) A denial of authorization based on the selection criteria set out in proposed section 246.12(g)(3)(iii) or (vi), (2) a denial of authorization based on the State agency's limiting criteria or because the vendor submitted its application outside the timeframes during which applications are being accepted and processed as established by the State agency under section 246.12(g)(6), (3) a termination of an agreement because of a change in ownership or location or cessation of operations, and (4) a disqualification based on the imposition of an FSP civil money penalty for hardship.

These actions each present circumstances in which the issue on appeal is a very narrow one. For example, the selection criterion at section 246.12(g)(3)(iii) would prohibit authorization of a vendor if the vendor or certain persons associated with the vendor had been convicted of the listed crimes. The only issue in such an appeal would be whether the vendor or a person currently associated with the vendor actually was convicted of the crime. Recognizing that errors can be made, this rule would require State agencies to provide such vendors an opportunity to point out, for example, that the conviction had been overturned or that the convicted person was no longer associated with the vendor. To reduce the costs of administrative reviews required by the regulations, this proposed rule would require State agencies to establish abbreviated administrative review procedures for such actions.

Proposed section 246.18(c) would specify the procedures for abbreviated administrative reviews. As with the current procedures, the State agency would be required to provide the vendor written notification of the adverse action, the procedures to follow to appeal the action, and the cause(s) and effective date of the action. The State agency would also be required to provide the vendor an opportunity to provide a written response. The State agency would not be required to conduct a full administrative review where the vendor is provided with an opportunity to confront and cross-examine adverse witnesses. All that would be required is a review of the information given to the vendor forming the basis for the adverse action, the vendor's response, and relevant statutes, regulations, policies, and procedures. The decision maker would not have to be independent from the State agency. The decision maker would only have to be someone different from the person who made the initial decision. These abbreviated administrative review procedures would provide the vendor an opportunity to appeal actions in which the decision is largely systematic. At the same time, it would eliminate the need for the State agency to provide a more lengthy and costly full administrative review.

Proposed section 246.18(a)(1)(iii) lists those actions that would not be subject to administrative review. As discussed in section 8 of this preamble and above in this section, while the validity or appropriateness of the limiting and selection criteria would not be subject to review, a decision to deny authorization would be subject to review. Similarly, the March 18 vendor sanction rule included a provision that participant access determinations are not subject to review. These provisions ensure that State agencies have the necessary discretion to establish program operating parameters. Limiting and selection criteria and the criteria for making participant access determinations would all be included in the State Plan. Concerns about these criteria are properly raised during the public comment phase of the State Plan process.

Some State agencies are beginning to implement vendor selection procedures in which applicant vendors submit competitive bids for a specified number of authorizations in a particular geographical area. Under this proposed rule, any time a State agency's authorization determinations are subject to the State agency's procurement procedures, nonselection would not be subject to review. In this situation, a separate administrative review would be redundant and could disrupt the procurement procedures.

Similarly, the Department proposes to eliminate administrative review of vendor claims given the requirement in current section 246.12(r)(5)(iii) (redesignated as section 246.12(k)(5) in this proposal) that State agencies provide vendors an opportunity to correct or justify the error giving rise to a claim. An administrative review in this instance would be redundant.

Under current sections 246.18(b)(1) and (9), timeframes are established for the advance notice of adverse action (15 days) and the notification of the appeal decision (within 60 days of the date of receipt of the vendor's request for administrative review). While the advance notice requirement is easily met, the 60-day timeframe for decisions has proven difficult for some State agencies, particularly those which must rely on a State board of appeals or other external organizational unit that is beyond the State agency's control. Therefore, the Department is proposing in section 246.18(b)(9) to extend the time limit for providing decisions on vendor—but not local agency—appeals to 90 days.

While there is some doubt that 90 days still may not be sufficient in some State agencies to render decisions on vendor appeals, other State agencies have been clearly able to meet the timeframe. The Department does not believe that there is sufficient justification for extending the time period beyond 90 days, nor would lengthening the time period promote the goal of improving and streamlining the appeals process. Rather, State agencies that have problems in this area should work to improve the efficiency of their appeals system. The Department hopes that the proposed limitations on actions subject to administrative review and the new abbreviated administrative review procedures will help State agencies reduce their costs for administrative

reviews and better target their efforts and thus assist in timely decisions on vendor appeals.

At proposed section 246.18(b)(5), the Department would provide State agencies the opportunity to conduct examinations *in camera,* i.e., behind a protective screen or other device, to protect the identity of WIC Program investigators. Protecting the identity of the investigator is paramount in conducting covert investigations and revealing the investigators identity during an administrative review would compromise future investigations.

Proposed section 246.18(b)(7) would strengthen current language regarding the disclosure of information to appellants. Current regulations at section 246.18(b)(7) afford the appellant vendor or local agency ''the opportunity to review the case record prior to the hearing.'' The vendor's ''case record,'' or file, may contain investigative information, i.e. information regarding how the State agency established the vendor's high-risk status, which, if released, would jeopardize efforts to combat program noncompliance. Thus, proposed section 246.18(b)(7) would clarify that the appellant vendor or local agency is allowed to examine only ''the evidence upon which the State agency's action is based.'' This restriction is consistent with due process rights. Appellant vendors would, under the confidentiality provisions proposed in section 246.26(e)(2), have access to information otherwise protected by current section 246.26(d), to the extent that such information is part of the evidence upon which the action being appealed is based.

The local agency adverse actions subject to administrative review are unchanged in this proposal, except they would be consolidated under 246.18(a)(2) with the current provision regarding the effective date of local agency adverse actions. In addition, sections 246.18 would be revised throughout to differentiate between a vendor or local agency which ''appeals'' an action and the State agency which ''reviews'' an action.

Finally, the current requirements in sections 246.18(c) and (d) would be redesignated as sections 246.18(d) and (f) and a new section 246.18(e) would be added. Current section 246.18(d) requires State agencies to notify appellants of the availability of any further administrative review within the State agency. The Department believes that this requirement duplicates the current requirement in section 246.18(b)(2) and proposed requirement in section 246.18(c) that the State agency inform vendors and local agencies of their opportunity to appeal the adverse action and could be viewed as encouraging State agencies to provide an additional level of administrative review. This section would be revised to make clear that the decisions rendered under both the full and abbreviated administrative review procedures are the final State agency action. If the action being appealed has not already taken effect, the appeal decision would be required to indicate the effective date of the action. The Department is also proposing to clarify the State agency requirements regarding judicial review. Instead of the current regulatory language that requires the State agency ''to explain'' the right to pursue judicial review, the Department proposes to require the State agency ''to inform'' appellants that they may be able to pursue judicial review. Review of State agency actions is a matter of State law and may vary depending on the action taken. The Department believes that the State agency should not be put in the position of determining the appropriate avenue of judicial review for an appellant vendor or local agency.

24. State Agency Corrective Action Plans and Delegation of Monitoring to Local Agencies (Sections 246.19(a)(2) and 246.19(b)(2)).

Under current regulations at section 246.19(a)(3)(ii), the State agency is required to submit a corrective action plan with implementation timeframes in response to management evaluations only when FNS has notified the State agency of its intention to impose a sanction. However, management evaluation findings may be significant and require timely corrective action even when they do not justify imposition of a sanction. As reported in the 1988 National Vendor Audit, some State agencies do not take timely action to correct deficiencies identified by FNS. Therefore, the Department is proposing in section 246.19(a)(2) that the State agency be required to submit a corrective action plan, including implementation timeframes, within 60 days of receipt of a management evaluation report containing negative findings even where the findings do not justify a sanction. The Department believes 60 days should be sufficient time to develop a corrective action plan. Extending the timeframe would unnecessarily prolong the time before corrective action could be achieved.

In addition, proposed section 246.19(b)(2) would require monitoring of local agencies to include, if the State agency delegates any vendor training or monitoring to local agencies, the local agency's effectiveness in carrying out these responsibilities.

25. Areas of Special Focus during Local Agency Reviews (Sections 246.19(b)(5) and (6))

Current regulatory requirements for coverage in local agency reviews at section 246.19(b)(2) are broad and very general in nature. State agencies are required, for example, to include ''certification'' and ''accountability'' in their local agency reviews. The Department believes that effective monitoring depends on comprehensive coverage. However, FNS may, from time to time, identify a problem in a more precisely defined aspect of local agency operations and may want State agencies to review this aspect intensively. For example, within the broad category of ''certification,'' there may be a need to focus attention on income eligibility determination procedures. Security of food instruments may be identified within the broader area of ''accountability'' as requiring in-depth monitoring. These targeted areas would be areas identified through management evaluations, audits, or other means which document the need for intensified monitoring and corrective action, as appropriate. Therefore, the Department is proposing in section 246.19(b)(5) to require State agencies to conduct in-depth review of areas specified by FNS through FNS policy memoranda or other guidance. Under this proposal, FNS could also require State agencies to implement a standard form or protocol for such focus-area reviews and to report the results to FNS. No more than two such areas would be stipulated for any fiscal year, and they would be announced at least six months before the beginning of the fiscal year. This provision would reflect the current requirement that State agencies provide FNS special reports on program activities.

The Department wishes to stress that this requirement does not mean that State agency reviews of local agencies should be less comprehensive than in the past. Full, comprehensive reviews of local agencies are necessary to identify deficiencies. This proposal simply enables FNS to gather information on areas of special emphasis in greater depth than might otherwise be possible. Areas of focus would change periodically, and there also could be fiscal years for which FNS does not identify any such areas.

In addition, section 246.19(b)(6) would be amended to require that local agencies submit to State agencies, within 45 days of written notification of deficiencies, a written corrective action

plan which explains how all of the identified problems will be addressed and stipulates a timeframe for completion of each corrective action. It is important that when problems are identified that they be corrected in a timely manner. State agencies are expected to pursue timely follow-up action to assure that planned corrective actions are actually taken.

26. Confidentiality of Vendor Information (Section 246.26(e))

The Department is proposing to add a new provision to section 246.26 of the WIC regulations addressing the confidentiality of vendor information. Heretofore, the WIC Program regulations have been silent on the issue of the confidentiality of vendor information, and provisions protecting vendor information from disclosure are still needed. The purpose of protecting vendor information is two-fold: to gain vendor cooperation and to aid in the control and monitoring of vendors.

Under this proposal, State agencies would be required to restrict the disclosure of information obtained from vendors or generated by the State agency on vendors (other than the vendor's name, address, and authorization status) to persons directly connected with the administration and enforcement of any Federal or State law, including the WIC Program and the FSP, and to the Comptroller General of the United States. While this would authorize local agencies under the State agency's jurisdiction, other WIC state and local agencies, and their contractors to receive vendor information, the proposed rule would require State agencies to enter into a written agreement with any non-Federal agency before disclosing any vendor information. The agreement would be required to specify that they will use or disclose such information only for authorized purposes directly connected with the administration or enforcement of a Federal or State law.

In accordance with the requirements in current sections 246.18(b)(1) and (7) that the State agency disclose to vendors the cause of the adverse action and provide them an opportunity to review the case record, proposed section 246.26(e)(2) would permit the disclosure to appellant vendors of information that forms the basis of an adverse action subject to administrative review. This would not include information concerning other vendors or information that would compromise the State agency's vendor monitoring system. While information about other vendors, such as average redemption data, might have been used to assist the State agency in targeting vendors for investigation, the Department does not consider such information as the basis for the State agency's action. Similarly, information that would compromise the State agency's monitoring system, such as the names of investigators, would not be considered to be information on which an action is based.

Efforts to control program noncompliance in the WIC Program are significantly enhanced by the State agency's access to information on vendors who also participate in the FSP. Section 9(c) of the Food Stamp Act of 1977 (7 U.S.C. 2018(c)) permits the FSP to disclose information provided by retail food stores and wholesale food concerns in order to gain or maintain authorization in the FSP to WIC State agencies for purposes of administering the provisions of the Child Nutrition Act and its implementing regulations. Proposed Section 246.26(f) would reflect this limitation and make clear that ''administering the provisions of the Child Nutrition Act'' includes both administering and enforcing the WIC Program. Accordingly, this information could not be disclosed to other vendors or the general public.

The FSP may share with WIC State agencies other information about authorized retailers that is not obtained from FSP retailer applications and is therefore not protected under section 9(c) of the Food Stamp Act. This information, e.g., results of investigations, along with information the WIC State agency collects directly from WIC vendors and its analysis of such material, contribute to the WIC State agency's vendor selection and high-risk detection systems. These systems can be effectively operated only if such data is protected from release to WIC vendors or other members of the public. State agency experience has shown that many vendors will commonly attempt to gain access to this information during the administrative review process. Such information must be kept confidential, so that vendors cannot secure unfair competitive advantages.

List of Subjects in 7 CFR Part 246

Food assistance programs, Food donations, Grant programs—Social programs, Infants and children, Maternal and child health, Nutrition education, Public assistance programs, WIC, Women.

For reasons set forth in the preamble, 7 CFR part 246 is proposed to be amended as follows:

PART 246—SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS AND CHILDREN

1. The authority citation for Part 246 continues to read as follows:

Authority: 42 U.S.C. 1786.

2. In § 246.2, the definitions of *Authorized Supplemental foods, Compliance buy, High-risk vendor, Home food delivery contractor, Inventory audit, Proxy, Routine monitoring, Vendor, Vendor authorization, Vendor limiting criteria, Vendor overcharge, Vendor selection criteria, Vendor violations,* and *WIC* are added in alphabetical order to read as follows:

§ 246.2 Definitions.

* * * * *

Authorized supplemental foods means those supplemental foods authorized by the State or local agency for a particular participant.

* * * * *

Compliance buy means a covert, on-site investigation in which a representative of the Program poses as a participant, transacts one or more food instruments, and does not reveal his or her identity during the visit.

* * * * *

High-risk vendor means a vendor identified as having a high probability of violating program requirements through application of the criteria established in § 246.12(j)(2) and any additional criteria established by the State agency.

Home food delivery contractor means a sole proprietorship, a partnership, a cooperative association, or a corporation that contracts with a State agency to deliver authorized supplemental foods to the residences of participants under a home food delivery system.

* * * * *

Inventory audit means the examination of food invoices or other proofs of purchase to determine whether a vendor has purchased sufficient quantities of authorized supplemental foods to provide participants the quantities specified on food instruments redeemed by the vendor during a given period of time.

* * * * *

Proxy means any person designated by a participant to act on her behalf and, in the case of an infant or child, the parent or caretaker who applies on behalf of the infant or child.

* * * * *

Routine monitoring means overt, on-site monitoring during which

representatives of the Program identify themselves to vendor personnel.

* * * * *

Vendor means a sole proprietorship, a partnership, a cooperative association, or a corporation operating an individual retail site authorized to provide authorized supplemental foods to participants under a retail food delivery system. Each individual retail outlet under a business entity which operates more than one site constitutes a separate vendor. Each vendor must have a fixed location, except when the authorization of mobile stores is necessary to meet the special needs described in the State agency's State Plan in accordance with § 246.4(a)(14)(xiv).

Vendor authorization means the process by which vendors who apply or subsequently reapply for authorization are assessed, selected, and enter into an agreement with the State agency.

Vendor limiting criteria means criteria established by the State agency to determine the maximum number and distribution of vendors to be authorized in its jurisdiction pursuant to § 246.12(g)(2).

Vendor overcharge means a pattern of intentionally or unintentionally charging participants more for authorized supplemental foods than non-WIC customers or charging participants more than the current shelf or contract price.

Vendor selection criteria means the criteria in § 246.12(g)(3) and any additional criteria established by the State agency to select individual vendors for program authorization.

Vendor violation means any intentional or unintentional actions of a vendor (with or without the knowledge of management) which violate the Program statute or regulations or State agency policies or procedures.

WIC means the Special Supplemental Nutrition Program for Women, Infants and Children authorized by section 17 of the Child Nutrition Act of 1966, 42 U.S.C. 1786.

3. In § 246.3:

a. Paragraph (e)(5) is redesignated as paragraph (e)(6); and

b. A new paragraph (e)(5) is added to read as follows:

§ 246.3 Administration.

* * * * *

(e) * * *

(5) For State agencies which anticipate 50 or more authorized vendors as of October 1 of each fiscal year, one full-time or equivalent vendor management specialist. State agencies which anticipate fewer than 50 authorized vendors as of that date shall designate a staff person responsible for vendor management.

* * * * *

4. In § 246.4:

a. Paragraphs (a)(14)(ii), (a)(14)(iii), (a)(14)(iv), and (a)(14)(vi) are revised;

b. In paragraphs (a)(14)(vii), (a)(14)(viii), and (a)(17) are amended by removing the words ''food vendors'' and adding in their place the word ''vendors'';

c. In paragraph (a)(14)(ix) the word ''and'' at the end is removed;

d. In paragraphs (a)(14)(x) and (xi) the periods at the end are removed and semicolons added in their place;

e. New paragraphs (a)(14)(xii) through (a)(14)(xv) are added; and

f. The first sentence of paragraph (a)(15) is revised.

The revisions and additions read as follows:

§ 246.4 State plan.

(a) * * *

(14) * * *

(ii) Vendor limiting criteria and any vendor selection criteria established by the State agency in addition to the selection criteria required by § 246.12(g)(3);

(iii) A sample vendor agreement, including the sanction schedule;

(iv) The system for monitoring vendors to ensure compliance and prevent fraud, waste, and program noncompliance, and the State agency's plans for improvement in the coming year. The State agency shall also include the criteria it will use to determine which vendors will receive routine monitoring visits. State agencies which intend to delegate any aspect of vendor monitoring responsibilities to a local agency or contractor shall describe the State agency supervision and training which will be provided to ensure the uniformity and quality of vendor monitoring efforts;

* * * * *

(vi) Where food instruments are used, a facsimile of the food instrument and a description of the system the State agency will use to account for the disposition of food instruments in accordance with § 246.12(q);

* * * * *

(xii) The procedures the State agency will use to train vendors in accordance with § 246.12(i). State agencies which intend to delegate any aspect of training to a local agency, contractor, or vendor representative shall describe the State agency supervision and instruction which will be provided to ensure the uniformity and quality of vendor training;

(xiii) A description of the State agency's system for ensuring food instrument security in accordance with § 246.12(p);

(xiv) A description of the State agency's participant access determination criteria consistent with § 246.12(l)(8); and

(xv) The special needs necessitating the authorization of mobile stores, if the State agency chooses to authorize such stores.

(15) Plans to prevent and identify dual participation in accordance with § 246.7(l)(1)(i) and (l)(1)(ii) * * *

* * * * *

5. In § 246.7:

a. In paragraph (h)(1)(i), the reference to ''§ 246.12(k)(2)'' is removed, and a reference to ''§ 246.12(u)'' is added in its place; and

b. Paragraph (l)(1)(i) through (l)(1)(iv) is revised.

The revision reads as follows:

§ 246.7 Certification of participants.

* * * * *

(l) * * *

(1) * * *

(i) In conjunction with WIC local agencies, the prevention and identification of dual participation within each local agency and between local agencies under the State agency's jurisdiction, including the quarterly identification of dual participation;

(ii) In areas where a local agency serves the same population as an Indian State agency or a CSFP agency, and where geographical or other factors make it likely that participants travel regularly between contiguous local service areas located across State agency borders, entering into an agreement with the other agency for the detection and prevention of dual participation. The agreement must be made in writing and included in the State Plan;

(iii) Immediate disqualification from one of the programs or clinics for participants found in violation due to dual participation;

(iv) In cases of dual participation resulting from intentional misrepresentation, the collection of improperly issued benefits in accordance with § 246.23(c)(1) and disqualification from both programs in accordance with § 246.12(u)(2).

* * * * *

6. Section 246.12 is revised to read as follows:

§ 246.12 Food delivery systems.

(a) *General.* This section sets forth design and operational requirements for food delivery systems. In recognition of emergent electronic benefits transfer (EBT) technology, FNS may, on a case-by-case basis, modify regulatory provisions which FNS determines

unnecessarily duplicate the accountability capabilities inherent in the particular EBT system.

(1) The State agency is responsible for the fiscal management of, and accountability for, food delivery systems under its jurisdiction.

(2) The State agency shall design all food delivery systems to be used by local agencies under its jurisdiction.

(3) FNS may, for a stated cause and by written notice, require revision of a proposed or operating food delivery system and will allow a reasonable time for the State agency to effect such a revision.

(4) All contracts or agreements entered into by the State or local agency for the management or operation of food delivery systems shall be in conformance with the requirements of Part 3016 of this title.

(b) *Uniform food delivery systems.* The State agency may operate up to three types of food delivery systems within its jurisdiction—retail, home delivery, or direct distribution. Each system shall be procedurally uniform within the jurisdiction of the State agency and shall ensure adequate participant access to supplemental foods. When used, food instruments shall be uniform within each type of system. The State agency shall permit only authorized vendors, home food delivery contractors, and direct distribution sites to redeem food instruments.

(c) *Free of charge.* State and local agencies shall provide participants the Program's supplemental foods free of charge.

(d) *Compatibility of food delivery system.* The State agency shall ensure that the food delivery system(s) selected is compatible with delivery of health and nutrition education services to participants.

(e) *Retail food delivery systems: General.* Retail food delivery systems are systems in which participants obtain supplemental foods by submitting a food instrument to an authorized vendor.

(f) *Retail food delivery systems: Food instrument requirements.* (1) State agencies using retail food delivery systems shall use food instruments and the food instruments shall comply with the requirements of this paragraph (f).

(2) Each printed food instrument shall clearly bear on its face the following information:

(i) The supplemental foods authorized to be obtained with the food instrument;

(ii) The first date on which the food instrument may be used by the participant to obtain supplemental foods.

(iii) The last date by which the participant may use the food instrument to obtain supplemental foods. This date shall be a minimum of 30 days from the first date on which it may be used, or, for the participant's first month of issuance, it may be the end of the month or cycle for which the food instrument is valid. Rather than entering a specific expiration date on each instrument, all instruments may be printed with a notice that the participant must transact them within a specified number of days after the first date on which the food instrument may be used.

(iv) The date by which the vendor must redeem the food instrument. This date shall be no more than 90 days from the first date on which the food instrument may be used. If the date is fewer than 90 days, then the State agency shall ensure that the time allotted provides the vendor sufficient time to redeem the food instruments without undue burden.

(v) A unique and sequential serial number.

(vi) At the discretion of the State agency, a maximum purchase price which is higher than the price of the supplemental food for which it will be used, but low enough to be a reasonable protection against potential loss of funds. When the maximum value is shown, the space for the actual value of the supplemental foods obtained shall be clearly distinguishable. For example, the words ''actual amount of sale'' could be printed larger and in a different area of the food instrument than the maximum value.

(vii) A signature space in which the participant or proxy must sign at the time the supplemental foods are obtained.

(3) The State agency shall implement procedures to ensure every redeemed food instrument can be identified by the vendor which redeemed the food instrument. Each individual vendor in a chain participating in the Program shall be separately identified. The State agency may identify vendors by requiring that all authorized vendors stamp their names and/or enter a vendor identification number on all redeemed food instruments prior to submission.

(g) *Retail food delivery systems: Vendor authorization.* (1) The State agency shall authorize an appropriate number and distribution of vendors in order to ensure adequate participant access to supplemental foods and to ensure effective State agency management, oversight, and review of authorized vendors in its jurisdiction.

(2) The State agency shall develop and implement criteria to limit the number of vendors to be authorized and establish their distribution. This system shall ensure adequate participant access and effective management, oversight, and review of authorized vendors in their jurisdiction. When developing limiting criteria, the State agency shall consider, at a minimum, participant access in terms of participant-to-vendor ratios based on population density, distribution of participants, location of local agencies and clinics, and availability of public transportation and road systems to the WIC population. The State agency shall apply its limiting criteria consistently throughout its jurisdiction taking into account varying geographic and other characteristics within the jurisdiction. The State agency shall establish a system for revising and/or reapplying its limiting criteria whenever it determines that relevant demographic shifts or significant changes in caseload allocation make such action necessary.

(3) The State agency shall develop and implement criteria to select vendors. The State agency shall apply its selection criteria consistently throughout its jurisdiction. The State agency may reassess any authorized vendor using these criteria at any time during the vendor's agreement period and shall terminate the agreements with those vendors that fail to meet them. In applying the criteria set forth in paragraphs (g)(3)(iii) through (g)(3)(vi) of this section, the State agency may rely on facts already known to it and representations made by applicant vendors; the State agency is not required to establish a formal system of background checks for applicant vendors. The selection criteria shall include:

(i) Competitive price;

(ii) Minimum variety and quantity of authorized supplemental foods;

(iii) Lack of a record of a criminal conviction or civil judgment of the applicant vendor or any person currently associated with the vendor as an owner, officer, director, or partner for: commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a public or private agreement or transaction; violation of Federal or State antitrust statutes, including those proscribing price fixing between competitors, allocation of customers between competitors, and bid rigging; commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property, making false claims, or obstruction of justice; or, commission of any other offense indicating a lack of business integrity or business honesty of the

vendor or its owner, officer, director, or partner;

(iv) Lack of a history, during a period preceding the date of application specified by the State agency (but not less than one year and not more than six years), of serious vendor violations resulting from the acts of omissions by the applicant vendor or any person currently associated with the vendor as an owner, officer, director, or partner, except that the time limit established by the State agency shall not apply to a vendor violation which results in a criminal conviction or civil judgment described in paragraph (e)(3)(iii) of this section. Serious vendor violations include: being subject to any of the vendor sanctions established in paragraph (l)(1) of this section and failure to participate in the annual training required by paragraph (i) of this section;

(v) Lack of a history, during a period preceding the date of application specified by the State agency (but not less than one year and not more than six years), of serious Food Stamp Program violations by the applicant vendor or any person currently associated with the vendor as an owner, officer, director, or partner, except that the time limit established by the State agency shall not apply to a Food Stamp Program violation which results in a criminal conviction or civil judgment described in paragraph (g)(3)(iii) of this section. Serious Food Stamp Program violations include: withdrawal of Food Stamp Program authorization for reasons of program noncompliance; a Food Stamp Program disqualification which is in effect at any time during this period; and assessment of a Food Stamp Program civil money penalty for hardship during this period; and

(vi) Not being currently disqualified from participation in the Food Stamp Program or, if a Food Stamp Program civil money penalty for hardship has been assessed, the period of the disqualification that would otherwise have been imposed has expired.

(4) The State agency shall not authorize an applicant vendor if the State agency determines the store has been sold by its previous owner in an attempt to circumvent a WIC sanction. The State agency may consider such factors as whether the applicant store was sold to a relative by blood or marriage of the previous owner(s) or sold to any individual or organization for less than its fair market value.

(5) The State agency is encouraged to consider the impact of authorization decisions on small businesses.

(6) The State agency may limit the periods during which applications for authorization from vendors will be accepted and processed, except that applications shall be accepted and processed at least once every three years. The State agency shall develop procedures for processing individual vendor applications outside of its timeframes for use when it determines there will be inadequate participant access unless additional vendors are authorized.

(7) At the time a vendor applies for authorization, the State agency shall collect the vendor's Food Stamp Program authorization number if the applicant vendor participates in that program. In addition, the State agency also shall collect the vendor's current shelf prices of authorized supplemental foods, unless the State agency uses competitive bidding to set vendor prices for such foods.

(h) *Retail food delivery systems: Vendor agreements.* (1) The State agency shall enter into written agreements with all authorized vendors. The agreements shall be for a period not to exceed three years. The agreement shall be signed by a representative who has legal authority to obligate the vendor and a representative of the State agency. When the vendor representative is obligating more than one vendor, all vendors shall be specified in the agreement. When more than one vendor is specified in the agreement, an individual vendor may be added or deleted without affecting the remaining vendors. The State agency shall require vendors to reapply at the expiration of their agreements and shall provide vendors with not less than 15 days advance written notice of the expiration of their agreements.

(2) The State agency shall use a standard vendor agreement throughout its jurisdiction, though the State agency may make exceptions to meet unique circumstances and must document the reasons.

(3) The vendor agreement shall contain the following specifications, although the State agency may determine the exact wording to be used:

(i) The vendor shall accept food instruments only from participants or their proxies.

(ii) The vendor shall provide participants only the supplemental foods listed on the food instrument. The vendor shall not substitute other foods or non-food items not listed on the food instrument, or provide cash in lieu of the listed supplemental foods. The vendor shall not give credit, including rainchecks, for supplemental foods listed on the food instruments, give refunds for supplemental foods obtained by participants with food instruments, or permit exchanges for supplemental foods obtained by participants except for identical supplemental foods.

(iii) The vendor shall accept food instruments from a participant only within the allowed time period, and submit them for payment within the allowed time period.

(iv) For printed food instruments, the vendor shall ensure the participant or proxy signs the food instrument and that the purchase price is entered on the food instrument before the participant or proxy signs it. In EBT systems, a Personal Identification Number (PIN) may be used in lieu of a signature.

(v) The vendor shall offer program participants the same courtesies as offered to other customers.

(vi) The vendor shall comply with the nondiscrimination provisions of Departmental regulations (Parts 15, 15a and 15b of this title).

(vii) The vendor shall not collect sales tax on WIC food purchases.

(viii) The vendor shall not charge the State agency more than the price charged other customers or the current shelf price, whichever is less, or, when the State agency uses competitive bidding to set vendor prices, the contract price. In no case may the vendor charge the State agency more than the competitive price limitation applicable to the area in which the vendor is located.

(ix) The vendor shall reimburse the State agency upon demand, or will have its payment from the State agency reduced, for the value of each vendor overcharge or other error. The State agency may collect the full redeemed value for each food instrument that contained a vendor overcharge or other error. The State agency may offset any amount owed by the vendor to the State agency against subsequent amounts to be paid to the vendor.

(x) The vendor shall not seek restitution from participants for food instruments not paid or partially paid by the State agency.

(xi) The manager of the vendor or other member of management shall participate in training prior to, or at the time of, the vendor's first authorization and annually thereafter, and sign and date a receipt acknowledging understanding of the training given. At least once during the agreement period such training will be face-to-face. Failure to participate in the annual training is a serious vendor violation that precludes subsequent authorization of the vendor. The State agency shall have sole discretion to determine the date, time, and place of all training, except that the vendor shall have at least one opportunity to attend annual

training on an alternative date established by the State agency. The State agency may, at its discretion, offer additional alternative training dates.

(xii) The vendor shall inform and train cashiers and other staff on program requirements.

(xiii) The vendor shall be accountable for actions of employees in the handling of food instruments.

(xiv) The vendor may be monitored for compliance with program rules.

(xv) The vendor shall maintain inventory records used for Federal tax reporting purposes and other records the State agency may require, for a period of time specified by the State agency. Upon request, the vendor shall make available to representatives of the State agency, the Department, and the Comptroller General of the United States, at any reasonable time and place for inspection and audit, all food instruments in the vendor's possession and all program-related records.

(xvi) Either the State agency or the vendor may terminate the agreement for cause after providing advance written notice within a timeframe established by the State agency, which may not be less than 15 days.

(xvii) The vendor shall give the State agency at least 45 days advance notification, in writing, of a change in vendor ownership, store location, or cessation of operations. In such instances, the vendor agreement shall be terminated, except that the State agency may permit vendors to move short distances without voiding the agreement. Changes in business structure (such as a corporate reorganization) without any change in ownership do not constitute a change of ownership.

(xviii) In addition to claims collection, the vendor may be sanctioned for vendor violations in accordance with the State agency's sanction schedule.

(xix) The vendor's agreement will be terminated if a conflict of interest is identified between the vendor and the State or local agencies.

(xx) A vendor who commits fraud or abuse in the Program is liable to prosecution under applicable Federal, State or local laws. Under § 246.23(d) of the regulations, those who have willfully misapplied, stolen or fraudulently obtained program funds shall be subject to a fine of not more than $10,000 or imprisonment for not more than five years or both, if the value of the funds is $100 or more. If the value is less than $100, the penalties are a fine of not more than $1,000 or imprisonment for not more than one year or both.

(xxi) The vendor agreement does not constitute a license or a property interest. If the vendor wishes to continue to be authorized beyond the period of its current agreement, the vendor must reapply for authorization. A vendor that has been disqualified for a period of time less than the remaining term of its vendor agreement may resume participation in the WIC Program upon completion of its disqualification period for the duration of the agreement without reapplying. If the vendor agreement expires before the vendor has served out the full disqualification period, and the vendor wishes to again participate in the Program, the vendor must apply to be authorized. In all cases, the vendor's new application will be subject to the State agency's selection and limiting criteria in effect at the time of the reapplication.

(xxii) The vendor shall be bound by any changes in the Program statute and regulations and State policies and procedures, including changes in selection criteria if the State agency chooses to reassess the vendor during the agreement period.

(xxiii) Disqualification from the WIC Program may result in disqualification as a retailer in the Food Stamp Program. Such disqualification may not be subject to administrative or judicial review under the Food Stamp Program.

(4) The State agency shall include in the vendor agreement the sanction schedule, which must be consistent with paragraph (l) of this section.

(5) The State agency shall include in the vendor agreement a list of the actions a vendor may appeal and a copy of the State agency's administrative review procedures, which are consistent with § 246.18.

(i) *Retail food delivery systems: Vendor training.* (1) The State agency shall provide training to all vendors prior to, or at the time of, initial authorization of a vendor, and annually thereafter. The training shall be designed to prevent program noncompliance and errors to improve program service. At the initial authorization of a new vendor, the training provided shall be face-to-face and on the site of the vendor. At least once during each subsequent agreement period, the State agency shall require that vendors attend face-to-face training at the site of the vendor or at another location. Both the initial training of a new vendor and the subsequent face-to-face training may fulfill the annual training requirement for the year in which it is given.

(2) The annual training shall include instruction in the purpose of the WIC Program; the varieties of supplemental foods authorized by the State agency; the minimum varieties and quantities of authorized supplemental foods that must be stocked by vendors; the procedures for transacting food instruments at the time of purchase and submitting food instruments for payment; the vendor sanction system; the vendor complaint process; the terms of the vendor agreement; and the claims collection procedures.

(3) The State agency may delegate the training to a local agency, a contractor, or a vendor representative if the State agency indicates its intention to do so in its State Plan in accordance with § 246.4(a)(14)(xii). In such cases, the State agency shall provide supervision and instruction to ensure the uniformity and quality of vendor training.

(4) The State agency shall ensure that the content of annual training is documented, including the signed vendor receipts required in paragraph (h)(3)(xi) of this section, and that each vendor signs and dates a receipt for annual training.

(j) *Retail food delivery systems:* Monitoring vendors and identifying high-risk vendors. (1) The State agency shall design and implement a system for monitoring vendors within its jurisdiction. The State agency may delegate the monitoring to a local agency or a contractor if the State agency indicates its intention to do so in its State Plan in accordance with § 246.4(a)(14)(iv). In such cases, the State agency shall provide supervision and training to ensure the uniformity and quality of the monitoring.

(2) The State agency shall identify high-risk vendors using criteria developed by FNS. FNS will not change these criteria more frequently than once every 2 years and will provide advance notification of changes 1 year prior to implementation. The State agency may develop and implement additional criteria.

(3)(i) The State agency shall conduct compliance buys or inventory audits on a minimum of 10 percent of the number of vendors authorized by the State agency as of October l of each fiscal year. The State agency shall conduct compliance buys or inventory audits on all high-risk vendors up to the 10 percent minimum, except that the State agency may waive a compliance buy or inventory audit on a high-risk vendor if it documents that the vendor is under investigation by a Federal, State or local law enforcement agency or that some other compelling reason exists for not conducting a compliance buy or inventory audit. An investigation of a high-risk vendor shall be considered

complete when the State agency determines that a sufficient number of compliance buys have been conducted to provide evidence of program noncompliance; when three compliance buys are conducted in which no program violations are found within a 12-month period; or when an inventory audit has been completed.

(ii) If fewer that 10 percent of the State agency's authorized vendors are identified as high-risk and not exempted from monitoring under paragraph (j)(2) of this section, the State agency shall randomly select additional vendors upon which to conduct compliance buys or inventory audits sufficient to meet the 10-percent minimum. An investigation of a randomly selected vendor shall be considered complete when, in the judgment of the State agency, sufficient evidence exists to determine whether or not the vendor is complying with program requirements.

(iii) If more than 10 percent of the State agency's authorized vendors are identified as high-risk and not exempted from monitoring under paragraph (j)(2) of this section, the State agency shall prioritize such vendors so as to perform compliance buys or inventory audits on those determined to have the greatest potential for program noncompliance and loss.

(4) For each fiscal year, the State agency shall send to FNS a summary of the results of vendor monitoring containing information stipulated by FNS. The report shall be sent by February 1 of the following fiscal year. Plans for improvement in the coming year shall be included in the State Plan, in accordance with the requirements of § 246.4(a)(14)(iv).

(5) The State agency shall document the following information for all monitoring visits, including compliance buys, inventory audits, and routine monitoring visits: the vendor's name and address; the date of the visit or inventory audit; the name(s) and signature(s) of the reviewer(s); and the nature of the problem(s) detected or the observation that the vendor appears to be in compliance with program requirements. For compliance buys, the State agency shall also document: the date of the buy; a description of the cashier involved in each transaction; the types and quantities of items purchased, shelf prices or contract prices, and price charged for each item purchased, if available; and the final disposition of all items as either destroyed, donated, provided to other authorities, or kept as evidence. Shelf or contract price information may be obtained prior to, during, or subsequent to the compliance buy.

(k) *Retail food delivery systems: Vendor claims.* (1) The State agency shall design and implement a system to identify vendor overcharges and other errors on redeemed food instruments not less frequently than quarterly. For printed food instruments, this system shall detect the following errors: purchase price missing, participant or proxy signature missing, vendor identification missing, redemption of expired food instruments, and, as appropriate, altered prices. The State agency shall implement procedures to reduce the number of errors where possible.

(2) The State agency may withhold or collect from the vendor the entire redeemed value of food instruments identified as containing a vendor overcharge or other error.

(3) The State agency shall also assess claims resulting from vendor violations identified in inventory audits or other reviews.

(4) The State agency shall initiate collection action within 90 days of the date of detection. Collection action may include offset.

(5) When payment for a food instrument is denied or delayed, or a claim for reimbursement is assessed, the State agency shall provide the vendor an opportunity to provide justification or correction. For example, if the actual price is missing, the vendor may demonstrate what price should have been included. If the State agency is satisfied with the correction or justification, it shall provide payment or adjust the claim accordingly.

(6) With justification and documentation, the State agency may pay vendors for food instruments redeemed after the expiration date. If the total value of the food instruments submitted at one time exceeds $200.00, payment may not be made without the approval of the FNS Regional Office.

(l) *Retail food delivery systems: Vendor sanctions*—(1) *Mandatory vendor sanctions.*

(i) *Permanent disqualification.* The State agency shall permanently disqualify a vendor convicted of trafficking in food instruments or selling firearms, ammunition, explosives, or controlled substances (as defined in section 102 of the Controlled Substances Act (21 U.S.C. 802)) in exchange for food instruments. A vendor shall not be entitled to receive any compensation for revenues lost as a result of such violation. If reflected in its State Plan, the State agency shall impose a civil money penalty in lieu of a disqualification for this violation when it determines, in its sole discretion, and documents that—

(A) Disqualification of the vendor would result in inadequate participant access; or

(B) The vendor had, at the time of the violation, an effective policy and program in effect to prevent trafficking; and the ownership of the vendor was not aware of, did not approve of, and was not involved in the conduct of the violation.

(ii) *Six-year disqualification.* The State agency shall disqualify a vendor for six years for: one incidence of buying or selling food instruments for cash (trafficking); or one incidence of selling firearms, ammunition, explosives, or controlled substances as defined in 21 U.S.C. 802, in exchange for food instruments.

(iii) *Three-year disqualification.* The State agency shall disqualify a vendor for three years for:

(A) One incidence of the sale of alcohol or alcoholic beverages or tobacco products in exchange for food instruments; or

(B) A pattern of claiming reimbursement for the sale of an amount of a specific supplemental food item which exceeds the store's documented inventory of that supplemental food item for a specific period of time; or

(C) A pattern of charging participants more for supplemental food than non-WIC customers or charging participants more than the current shelf or contract price; or

(D) A pattern of receiving, transacting and/or redeeming food instruments outside of authorized channels, including the use of an unauthorized vendor and/or an unauthorized person; or

(E) A pattern of charging for supplemental food not received by the participant; or

(F) A pattern of providing credit or non-food items, other than alcohol, alcoholic beverages, tobacco products, cash, firearms, ammunition, explosives, or controlled substances as defined in 21 U.S.C. 802, in exchange for food instruments.

(iv) *One-year disqualification.* The State agency shall disqualify a vendor for one year for a pattern of providing unauthorized food items in exchange for food instruments, including charging for supplemental food provided in excess of those listed on the food instrument.

(v) *Second mandatory sanction.* When a vendor, who previously has been assessed a sanction for any of the violations in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section, receives another sanction for any of these violations, the State agency shall double the second sanction. Civil money penalties may only be doubled up to the

limits allowed under paragraph (l)(1)(x)(C) of this section.

(vi) *Third or subsequent mandatory sanction.* When a vendor, who previously has been assessed two or more sanctions for any of the violations listed in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section, receives another sanction for any of these violations, the State agency shall double the third sanction and all subsequent sanctions. The State agency shall not impose civil money penalties in lieu of disqualification for third or subsequent sanctions for violations listed in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section.

(vii) *Disqualification based on a Food Stamp Program disqualification.* The State agency shall disqualify a vendor who has been disqualified from the Food Stamp Program. The disqualification shall be for the same length of time as the Food Stamp Program disqualification, may begin at a later date than the Food Stamp Program disqualification, and shall not be subject to administrative or judicial review under the WIC Program.

(viii) *Voluntary withdrawal or nonrenewal of agreement.* The State agency shall not accept voluntary withdrawal of the vendor from the Program as an alternative to disqualification for the violations listed in paragraphs (l)(1)(i) through (l)(1)(iv) of this section, but shall enter the disqualification on the record. In addition, the State agency shall not use nonrenewal of the vendor agreement as an alternative to disqualification.

(ix) *Participant access determinations.* Prior to disqualifying a vendor for a Food Stamp Program disqualification pursuant to paragraph (l)(1)(vii) of this section or for any of the violations listed in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section, the State agency shall determine if disqualification of the vendor would result in inadequate participant access. If the State agency determines that disqualification of the vendor would result in inadequate participant access, the State agency shall impose a civil money penalty in lieu of disqualification. However, as provided in paragraph (l)(1)(vi) of this section, the State agency shall not impose a civil money penalty in lieu of disqualification for third or subsequent sanctions for violations in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section. The State agency shall include documentation of its participant access determination and any supporting documentation in the file of each vendor who is disqualified or receives a civil money penalty in lieu of disqualification.

(x) *Civil money penalty formula.* For each violation subject to a mandatory sanction, the State agency shall use the following formula to calculate a civil money penalty imposed in lieu of disqualification:

(A) Determine the vendor's average monthly redemptions for at least the 6-month period ending with the month immediately preceding the month during which the notice of administrative action is dated;

(B) Multiply the average monthly redemptions figure by 10 percent (.10);

(C) Multiply the product from paragraph (l)(1)(x)(B) of this section by the number of months for which the store would have been disqualified. This is the amount of the civil money penalty, provided that the civil money penalty shall not exceed $10,000 for each violation. For a violation that warrants permanent disqualification, the amount of the civil money penalty shall be $10,000. When during the course of a single investigation the State agency determines a vendor has committed multiple violations, the State agency shall impose a CMP for each violation. The total amount of civil money penalties imposed for violations investigated as part of a single investigation shall not exceed $40,000.

(xi) *Notification to FNS.* The State agency shall provide the appropriate FNS office with a copy of the notice of administrative action and information on vendors it has either disqualified or imposed a civil money penalty in lieu of disqualification for any of the violations listed in paragraphs (l)(1)(i) through (l)(1)(iv) of this section. This information shall include the name of the vendor, address, identification number, the type of violation(s), and the length of disqualification or the length of the disqualification corresponding to the violation for which the civil money penalty was assessed, and shall be provided within 15 days after the vendor's opportunity to file for a WIC administrative review has expired or all of the vendor's WIC administrative reviews have been completed.

(xii) *Multiple violations during a single investigation.* When during the course of a single investigation the State agency determines a vendor has committed multiple violations (which may include violations subject to State agency sanctions), the State agency shall disqualify the vendor for the period corresponding to the most serious mandatory violation. However, the State agency shall include all violations in the notice of administration action. If a mandatory sanction is not upheld on appeal, then the State agency may impose a State agency-established sanction.

(2) *State agency vendor sanctions.* (i) The State agency may impose sanctions for violations that are not specified in paragraphs (l)(1)(i) through (l)(1)(iv) of this section as long as such violations and sanctions are included in the vendor agreement. State agency sanctions may include disqualifications, civil money penalties assessed in lieu of disqualification, and fines. The total period of disqualification imposed for State agency violations investigated as part of a single investigation may not exceed one year. A civil money penalty or fine shall not exceed $10,000 for each violation. The total amount of civil money penalties imposed for violations investigated as part of a single investigation shall not exceed $40,000.

(ii) The State agency may disqualify a vendor who has been assessed a civil money penalty for hardship in the Food Stamp Program, as provided under § 278.6 of this chapter. The length of such disqualification shall correspond to the period for which the vendor would otherwise have been disqualified in the Food Stamp Program. If a State agency decides to exercise this option, the State agency shall:

(A) Include notification that it will take such disqualification action in its vendor agreement, in accordance with paragraph (f)(4) of this section; and

(B) Determine if disqualification of the vendor would result in inadequate participant access in accordance with paragraph (l)(8) of this section. If the State agency determines that disqualification of the vendor would result in inadequate participant access, the State agency shall not disqualify the vendor or impose a civil money penalty in lieu of disqualification. The State agency shall include documentation of its participant access determination and any supporting documentation in each vendor's file.

(3) *Prior warning.* The State agency does not have to provide the vendor with prior warning that violations were occurring before imposing any of the sanctions in this paragraph (l).

(4) *Appeal procedures.* The State agency shall provide adequate procedures for vendors to appeal a disqualification from participation under the Program as specified in § 246.18.

(5) *Installment plans.* The State agency may use installment plans for the collection of civil money penalties and fines.

(6) *Failure to pay a civil money penalty.* If a vendor does not pay, only partially pays, or fails to timely pay a

civil money penalty assessed in lieu of disqualification, the State agency shall disqualify the vendor for the length of the disqualification corresponding to the violation for which the civil money penalty was assessed (for a period corresponding to the most serious violation in cases where a mandatory sanction included the imposition of multiple civil money penalties as a result of a single investigation).

(7) *Actions in addition to sanctions.* Vendors may be subject to actions in addition to the sanctions in this section, such as claims for improper or overcharged food instruments and penalties outlined in § 246.23, in the case of deliberate fraud.

(8) *Participant access determination criteria.* When making participant access determinations, the State agency shall consider, at a minimum, the availability of other authorized vendors in the same area as the violative vendor and any geographic barriers to using such vendors.

(m) *Home food delivery systems.* Home food delivery systems are systems in which food is delivered to the participant's home. Systems for home delivery of food shall provide for:

(1) Procurement of supplemental foods in accordance with § 246.24, which may entail measures such as the purchase of food in bulk lots by the State agency and the use of discounts that are available to States.

(2) The accountable delivery of supplemental foods to participants. The State agency shall ensure that:

(i) Home food delivery contractors are paid only after the delivery of supplemental foods to participants;

(ii) There exists a routine procedure to verify the correct delivery of prescribed supplemental foods to participants, and, at a minimum, such verification occurs at least once a month after delivery; and

(iii) There is retention of records of delivery of supplemental foods and bills sent or payments received for such supplemental foods for at least three years and access of State, local and/or Federal authorities to such records.

(n) *Direct distribution food delivery systems.* Direct distribution food delivery systems are systems in which participants or their proxies pick up food from storage facilities operated by the State or local agency. Systems for direct distribution of food shall provide for:

(1) Adequate storage and insurance coverage that minimizes the danger of loss to theft, infestation, fire, spoilage, or other causes;

(2) Adequate inventory control of food received, in stock, and issued;

(3) Procurement of supplemental foods, in accordance with § 246.24, which may entail measures such as purchase of food in bulk lots by the State agency and the use of discounts that are available to States;

(4) The availability of program benefits to participants and potential participants who live at great distance from storage facilities; and

(5) The accountable delivery of supplemental foods to participants.

(o) *Participant, vendor, and home food delivery contractor complaints.* The State agency shall have procedures that document the handling of complaints by participants, vendors, and home food delivery contractors. Complaints of civil rights discrimination shall be handled in accordance with § 246.8(b).

(p) *Food instrument security.* The State agency shall develop minimum standards for ensuring the security of food instruments from the time the food instruments are created or received by the State agency to the time of issuance to participants at local agencies and clinics. These standards shall include maintenance by the local agency of perpetual inventory records of receipt of food instruments from the State agency and, if applicable, distribution to clinics; monthly physical inventory of food instruments on hand by the local agency and, if applicable, clinics; reconciliation of perpetual and physical inventories of food instruments; and, maintenance of all food instruments under lock and key by the State agency, local agencies and clinics, except for supplies needed for immediate use.

(q) *Food instrument disposition.* The State agency shall account for the disposition of all food instruments as issued or voided, and as redeemed or unredeemed. Redeemed food instruments shall be identified as validly issued, lost, stolen, expired, duplicate, or not matching valid issuance and enrollment records. In an EBT system, evidence of matching redeemed food instruments to a valid issuance and enrollment record may be satisfied through the linking of the PIN associated with the electronic transaction to a valid issuance and enrollment record. This process shall be performed within 150 days of the first valid date for participant use of the food instruments and shall be conducted in accordance with the financial management requirements of § 246.13. The State agency shall be subject to claims as outlined in § 246.23(a)(4) for redeemed food instruments that do not meet the conditions established in this paragraph (q).

(r) *Issuance of food instruments and supplemental foods.* The State agency shall:

(1) Establish uniform procedures which allow proxies designated by participants to act on their behalf. In determining whether a particular participant should be allowed to designate a proxy or proxies, the State agency shall require the local agency or clinic to consider whether adequate measures can be implemented to provide nutrition education and health care referrals to that participant;

(2) Ensure that the participant or proxy signs for receipt of food instruments or supplemental foods, except as established in paragraph (r)(4) of this section;

(3) Ensure that participants and their proxies receive instructions on the proper use of food instruments, or on the procedures for receiving supplemental foods when food instruments are not used. Participants and their proxies shall also be notified that they have the right to complain about improper vendor and home food delivery contractor practices with regard to program responsibilities;

(4) Require participants or their proxies to pick up food instruments in person when scheduled for nutrition education or for an appointment to determine whether participants are eligible for a second or subsequent certification period. However, in all other circumstances the State agency may provide for issuance through an alternative means such as EBT or mailing, unless FNS determines that such actions would jeopardize the integrity of program services or program accountability. If a State agency opts to mail food instruments, it must provide justification, as part of its alternative issuance system in its State Plan, as required in § 246.4(a)(21), for mailing food instruments to areas where food stamps are not mailed. State agencies which opt to mail food instruments must establish and implement a system which ensures the return of food instruments to the State or local agency if the participants no longer resides or receives mail at the address to which the food instruments were mailed; and

(5) Ensure that no more than a three-month supply of food instruments or supplemental foods is issued to any participant at one time.

(s) *Payment to vendors and home food delivery contractors.* The State agency shall ensure that vendors and home food delivery contractors are promptly paid for food costs. Payment for valid food instruments redeemed shall be made within 60 days after receipt of the food instruments. Actual

payment to vendors and home food delivery contractors may be made by local agencies.

(t) *Conflict of interest.* The State agency shall ensure that no conflict of interest exists between the State agency and any vendor or home food delivery contractor, or between any local agency and any vendor or home food delivery contractor under its jurisdiction.

(u) *Participant violations and sanctions.*—(1) *Participant violations.* The State agency shall establish procedures designed to control participant violations of program requirements. Participant violations include the following actions by a participant or a proxy: intentionally making false or misleading statements or intentionally misrepresenting, concealing, or withholding facts to obtain benefits; sale of supplemental foods or food instruments to, or exchange with, other individuals or entities; receipt from food vendors of cash or credit toward purchase of unauthorized food or other items of value in lieu of authorized supplemental foods; physical abuse, or threat of physical abuse, of clinic or vendor staff; and dual participation.

(2) *Participant sanctions.* The State agency shall establish sanctions for participant violations. Such sanctions may include disqualification from the Program for a period up to one year. In cases in which the participant violation gives rise to a claim (including dual participation), the participant shall be disqualified for one year, except if the participant is an infant or child. In those cases, the State agency may permit another proxy to be designated. If an alternate proxy acceptable to the State agency cannot be found, the infant or child shall be disqualified for one year. However, if full restitution is made prior to the end of the disqualification period, the State agency may permit the participant to reapply for the Program. Warnings may be given prior to the imposition of sanctions. Before a participant is disqualified from the Program for an alleged violation, that participant shall be given full opportunity to appeal the disqualification as set forth in § 246.9.

(v) *Referral to law enforcement authorities.* The State agency shall refer vendors, home food delivery contractors, and participants who violate the Program to Federal, State or local authorities for prosecution under applicable statutes, where appropriate.

7. In § 246.13, paragraph (h) is revised to read as follows:

§ 246.13 Financial management system.

* * * * *

(h) *Adjustment of expenditures.* The State agency shall adjust projected expenditures to account for redeemed food instruments and for other changes as appropriate.

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8. In § 246.18:

a. The section heading is revised;

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

c. Paragraphs (c) and (d) are redesignated as paragraphs (d) and (f), respectively, and are revised, and new paragraphs (c) and (e) are added.

The revisions and additions read as follows:

§ 246.18 Administrative review of State agency actions.

(a)(1) *Vendor appeals.*—(i) *Actions receiving full administrative reviews.* Except as provided elsewhere in this paragraph (a)(1), the State agency shall provide a full administrative review to vendors that appeal the following actions: a denial of authorization based on the selection criteria or on a determination that the vendor is attempting to circumvent a sanction, a termination of an agreement for cause, a disqualification, and the imposition of a fine or a civil money penalty in lieu of disqualification.

(ii) *Actions receiving abbreviated administrative reviews.* Except as provided elsewhere in this paragraph (a)(1), the State agency shall provide an abbreviated administrative review to vendors that appeal the following actions: a denial of authorization based on the selection criteria in § 246.12(g)(3)(iii) or (g)(3)(vi), the State agency's limiting criteria, or because the vendor submitted its application outside the timeframes during which applications are being accepted and processed as established by the State agency under § 246.12(g)(6); termination of an agreement because of a change in ownership or location or cessation of operations; and a disqualification based on the imposition of a Food Stamp Program civil money penalty for hardship.

(iii) *Actions not subject to administrative review.* The State agency shall not review a vendor's appeal of the following: the validity or appropriateness of the State agency's limiting or selection criteria as defined in § 246.2, the State agency's participant access determinations, authorization determinations subject to the State agency's procurement procedures, the expiration of the vendor's agreement, disputes regarding food instrument payments, vendor claims, and disqualification of a vendor as a result of disqualification from the Food Stamp Program.

(2) *Local agency appeals.* The State agency shall grant a full administrative review to local agencies that appeal the following actions: a denial of a local agency's application to participate, a local agency's disqualification, or any other adverse action that affects a local agency's participation. Expiration of an agreement with a local agency shall not be subject to review. The State agency shall postpone the effective date of adverse actions that are subject to review (except denials of applications to participate) until a decision is made on the local agency's appeal.

(3) *Effective dates of actions against vendors.* Denials of vendor authorization and disqualifications imposed under § 246.12(l)(1)(i) shall be made effective on the date of receipt of the notice of administrative action. All other adverse actions subject to administrative review shall be effective no earlier than 15 days after the date of the notice of the action. A State agency may postpone the effective date of an adverse action subject to administrative review (except for denials of authorization and disqualifications imposed under § 246.12(l)(1)(i)) until a decision is made on the vendor's appeal, only if the State agency determines that the delay is necessary to ensure either adequate participant access or the effective and efficient operation of the Program.

(b) *Full administrative review procedure.* The State agency shall develop procedures for a full administrative review of the actions listed in § 246.18(a)(1)(i) and (a)(2). The procedures shall provide the local agency or vendor with the following:

(1) Written notification of the administrative action, the procedures to file for an administrative review, if any, and the cause(s) for and the effective date of the action. Such notification shall be provided to participating vendors not less than 15 days in advance of the effective date of the action. When a vendor is disqualified due in whole or in part to violations in § 246.12(l)(1), such notification shall include the following statement: ''This disqualification from WIC may result in disqualification as a retailer in the Food Stamp Program. Such disqualification may not be subject to administrative or judicial review under the Food Stamp Program.'' In the disqualification of local agencies, the State agency shall provide not less than 60 days advance notice of pending action.

(2) The opportunity to appeal the adverse action within a time period

specified by the State agency in its notification of adverse action.

(3) Adequate advance notice of the time and place of the administrative review to provide all parties involved sufficient time to prepare for the review.

(4) The opportunity to present its case and at least one opportunity to reschedule the administrative review date upon specific request. The State agency may set standards on how many review dates can be scheduled, provided that a minimum of two review dates is allowed.

(5) The opportunity to cross-examine adverse witnesses. Where necessary to protect the identity of WIC Program investigators, such examination may be conducted *in camera*.

(6) The opportunity to be represented by counsel, if desired.

(7) The opportunity to examine the evidence upon which the State agency's action is based prior to the review.

(8) An impartial decision-maker, whose determination is based solely on whether the State agency has correctly applied its policies and procedures, according to the evidence presented at the review and the statutory and regulatory provisions governing the Program. State agencies may appoint a reviewing official, such as a chief hearing officer or judicial officer, to review appeal decisions to ensure that they conform to approved policies and procedures.

(9) Written notification of the decision on the appeal, including the basis for the decision, within 90 days from the date of receipt of a vendor's request for an administrative review, and within 60 days from the date of receipt of a local agency's request for an administrative review.

(c) *Abbreviated administrative review procedures.* The State agency shall develop procedures for an abbreviated administrative review of the actions listed in § 246.18(a)(1)(ii). These procedures shall provide the vendor written notification of the adverse action, the procedures to follow for an abbreviated administrative review, the cause(s) and the effective date of the action, and an opportunity to provide a written response. The State agency shall render a decision based on the information provided to the vendor, the vendor's response, and relevant statutes, regulations, policies and procedures. The decision maker shall be someone other than the person who rendered the initial decision on the action. The decision maker shall provide the vendor a written decision on the appeal, including the basis for the decision.

(d) *Continuing responsibilities.* Appealing an action does not relieve a local agency, or a vendor permitted to continue in the Program while its appeal is in process, from the responsibility of continued compliance with the terms of any written agreement with the State or local agency.

(e) *Finality and effective date of decisions.* The State agency procedures shall provide that the decisions rendered under both the full and abbreviated review procedures are the final State agency action. If the action under appeal has not already taken effect, the action shall take effect on the date of receipt of the decision.

(f) *Judicial review.* If the decision on the appeal is rendered against the local agency or vendor, the State agency shall inform the appellant that it may be able to pursue judicial review of the decision.

12. In § 246.19, paragraphs (a)(2), (b)(2), (b)(5) and (b)(6) are revised to read as follows:

§ 246.19 Management evaluation and reviews.

(a) * * *

(2) The State agency shall submit a corrective action plan, including implementation timeframes, within 60 days of receipt of an FNS management evaluation report containing negative findings. If FNS determines through a management evaluation or other means that during a fiscal year the State agency has failed, without good cause, to demonstrate efficient and effective administration of its program, or has failed to comply with its corrective action plan, or any other requirements contained in this part or the State Plan, FNS may withhold an amount up to 100 percent of the State agency's nutrition services and administration funds, for that year.

* * * * *

(b) * * *

(2) Monitoring of local agencies shall encompass, but need not be limited to, evaluation of management, certification, nutrition education, participant services, civil rights compliance, accountability, financial management systems, and food delivery systems. If the State agency delegates vendor training or monitoring to the local agency, it shall evaluate the local agency's effectiveness in carrying out these responsibilities.

* * * * *

(5) FNS may require the State agency to conduct in-depth reviews of specified areas of local agency operations, to implement a standard form or protocol for such reviews, and to report the results to FNS. No more than two such areas will be stipulated by FNS for any fiscal year. These areas will be announced by FNS at least six months before the beginning of the fiscal year.

(6) The State agency shall require local agencies to establish management evaluation systems to review their operations and those of associated clinics or contractors and shall require, within 45 days of written notification of deficiencies, a written corrective action plan which explains how all of the identified problems will be addressed and stipulates timeframes for completion of each corrective action.

13. In § 246.23, paragraphs (a)(4) and (c) are revised to read as follows:

§ 246.23 Claims and penalties.

(a) * * *

(4) FNS will establish a claim against any State agency which has not accounted for the disposition of all redeemed food instruments and taken appropriate follow-up action on all redeemed food instruments which cannot be matched against valid issuance and certification records, including cases which may involve fraud, unless the State agency has demonstrated to the satisfaction of FNS that it has:

(i) Made every reasonable effort to comply with this requirement;

(ii) Identified the reasons for its inability to account for the disposition of each redeemed food instrument; and

(iii) Provided assurances that, to the extent considered necessary by FNS, it will take appropriate actions to improve its procedures.

* * * * *

(c) *Claims against participants.* (1) If the State agency determines that program benefits have been improperly obtained as the result of a participant or proxy intentionally making a false or misleading statement or intentionally misrepresenting, concealing, or withholding facts, the State agency shall issue a letter requesting repayment and indicating that, if the request for repayment is not appealed or is unsuccessfully appealed, the participant must be disqualified in accordance with § 246.12(u)(2). If the participant does not make full restitution in response to this letter, the State agency shall weigh the cost of each subsequent action in the collection process against the amount to be recovered and take such action until recovery is achieved or until the recovery process ceases to be cost-effective. The State agency may allow participants for whom financial restitution would cause undue hardship to perform in-kind service determined by the State agency in lieu of restitution. If full restitution is made prior to the end of the disqualification period, the State agency may permit the participant

to reapply for the Program. The State agency shall maintain on file documentation of the disposition of all cases of improperly obtained program benefits covered by this paragraph (c).

(2) FNS will assert a claim against the State agency for losses resulting from program funds improperly spent as a result of dual participation, if FNS determines that the State agency has not complied with the requirements in § 246.12(u)(2) concerning participant sanctions or the requirements in paragraph (c)(2) of this section concerning participant claims.

(3) The State agency may delegate to its local agencies the responsibility for the collection of participant claims.

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14. In § 246.26, the heading of paragraph (d) is revised, and paragraphs (e) and (f) are added to read as follows.

§ 246.26 Other provisions.

* * * * *

(d) *Confidentiality of applicant and participant information.* * * *

* * * * *

(e) *Confidentiality of vendor information.* Except for vendor name, address and authorization status, the State agency shall restrict the use or disclosure of information obtained from vendors, or generated by the State agency concerning vendors, to:

(1) Persons directly connected with the administration or enforcement of any Federal or State law, including the WIC Program or the Food Stamp Program, and the Comptroller General of the United States. Prior to releasing the information to a party other than a Federal agency, the State agency shall enter into a written agreement with the requesting party specifying that such information may not be used or redisclosed except for purposes directly connected to the administration or enforcement of a Federal or State law; and

(2) Appellant vendors, to the extent that the information to be disclosed is a basis of the action under review as set forth in § 246.18(b)(1), (b)(7), and (c).

(f) *Confidentiality of Food Stamp Program retailer information.* The State agency shall restrict the use or disclosure of Food Stamp Program retailer information furnished to it, pursuant to Section 9(c) of the Food Stamp Act of 1977 (7 U.S.C. 2018(c)) and § 278.1(r) of this chapter to persons directly connected with the administration or enforcement of the WIC Program.

Dated: June 7, 1999.

Shirley R. Watkins,

Under Secretary for Food, Nutrition and Consumer Services.

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