

First Financial's FSA Card Substantiation Process



First Financial Administrators (FFA) takes compliance of our administration seriously. We have outlined below information from the IRS regulations regarding Section 125 Flexible Spending Accounts and the processes we have implemented to keep your plan in compliance.

The IRS allows three options for FSA card transactions to be automatically approved without validation, also called substantiation.

1. IIAS system adjudicates the transaction. IIAS is an Inventory Information Approval System that is required to be in place for facilities that sell medications and over the counter items. IIAS maintains the list of all over the counter and prescriptions SKU numbers. IIAS approves most transactions for prescriptions and eligible over the counter items.
2. Transactions are set to recurring when we can see a participant has the same service and the same amount charged on a regular basis; for example monthly orthodontia or chiropractic visits.
3. FFA will load your employer health, dental and vision co-payments. We can approve up to 5 times these co-payments.

In order to keep your plan in compliance with IRS regulations we request employees send in documentation for transactions that do not meet these IRS auto approval processes. Our current process is to send out three notices by email or mail to the participant asking them to mail, fax, email, upload to the portal or take a photo and upload to our new phone app. We are trying to make it as simple as possible for participants to provide the required documents. If we do not receive a response after 60 days the card will be temporarily deactivated until we receive the documentation.

THE DETAILED RECEIPT OR EXPLANATION OF BENEFITS MUST INCLUDE:

- **Date of Service was incurred**
- **Type of Service performed**
- **Doctor or Facility who performed the service**
- **Amount you had to pay out of pocket after insurance paid**
- **Medical Determination required for some expenses**
- **Explanation of Benefits generally has all information needed**
- **Prepayments or Payments outside of plan year are ineligible**

The Section 125 Cafeteria plan, which includes the FSA plans, is implemented and administered by the employer and by doing this the IRS has mandated several requirements to receive this pre-tax benefit. The employer can hire a Third Party Administrator to provide administration of the plan. It is the employer's responsibility to maintain these guidelines and the compliance of the plan. If there is an audit, the IRS will not request the documentation from the employee, they will ask the employer sponsoring the plan to prove all documentation has been substantiated. If employers' are ever audited the IRS can assess penalties to the employer and also make all pre-tax benefits ineligible back to the inception of the plan. This means all employees who had pre-tax medical, dental, vision, FSA plans etc. would have to pay the tax on these benefits.

One of the benefits of hiring FFA as your Third Party Administrator for FSAs is to maintain the compliance of your Section 125 plan in case of an IRS audit. Below is an excerpt and the link to the published guidelines on the IRS website.

§1.125-6 Substantiation of expenses for all cafeteria plans.

(a) *Cafeteria plan payments and reimbursements—(1) In general.* A cafeteria plan may pay or reimburse only those substantiated expenses for qualified benefits incurred on or after the later of the effective date of the cafeteria plan and the date the employee is enrolled in the plan. This requirement applies to all qualified benefits offered through the cafeteria plan. See paragraph (b) of this section for substantiation rules.

(b) *Rules for claims substantiation for cafeteria plans—(1) Substantiation required before reimbursing expenses for qualified benefits.* This paragraph (b) sets forth the substantiation requirements that a cafeteria plan must satisfy before paying or reimbursing any expense for a qualified benefit.

(2) *All claims must be substantiated.* As a precondition of payment or reimbursement of expenses for qualified benefits, a cafeteria plan must require substantiation in accordance with this section. Substantiating only a percentage of claims, or substantiating only claims above a certain dollar amount, fails to comply with the substantiation requirements in §1.125-1 and this section.

(3) *Substantiation by independent third-party.* (i) *In general.* All expenses must be substantiated by information from a third-party that is independent of the employee and the employee's spouse and dependents. The independent third-party must provide information describing the service or product, the date of the service or sale, and the amount. Self-substantiation or self-certification of an expense by an employee does not satisfy the substantiation requirements of this paragraph (b). The specific requirements in sections 105(b), 129, and 137 must also be satisfied as a condition of reimbursing expenses for qualified benefits. For example, a health FSA does not satisfy the requirements of section 105(b) if it reimburses employees for expenses where the employees only submit information describing medical expenses, the amount of the expenses and the date of the expenses but fail to provide a statement from an independent third-party (either automatically or subsequent to the transaction) verifying the expenses. Under §1.105-2, all amounts paid under a plan that permits self-substantiation or self-certification are includible in gross income, including amounts reimbursed for medical expenses, whether or not substantiated. See paragraph (m) in §1.125-5 for additional substantiation rules for limited-purpose and post-deductible health FSAs.

(ii) *Rules for substantiation of health FSA claims using an explanation of benefits provided by an insurance company.* (A) *Written statement from an independent third-party.* If the employer is provided with information from an independent third-party (such as an "explanation of benefits" (EOB) from an insurance company) indicating the date of the section 213(d) medical care and the employee's responsibility for payment for that medical care (that is, coinsurance payments and amounts below the plan's deductible), and the employee certifies that any expense paid through the health FSA has not been reimbursed and that the employee will not seek reimbursement from any other plan covering health benefits, the claim is fully substantiated without the need for submission of a receipt by the employee or further review

(1) Before any employee participating in a health FSA receives the debit card, the employee agrees in writing that he or she will only use the card to pay for medical expenses (as defined in section 213(d)) of the employee or his or her spouse or dependents, that he or she will not use the debit card for any medical expense that has already been reimbursed, that he or she will not seek reimbursement under any other health plan for any expense paid for with a debit card, and that he or she will acquire and retain sufficient documentation (including invoices and receipts) for any expense paid with the debit card.

(2) The debit card includes a statement providing that the agreements described in paragraph (d)(1) of this section are reaffirmed each time the employee uses the card.

(3) The amount available through the debit card equals the amount elected by the employee for the health FSA for the cafeteria plan year, and is reduced by amounts paid or reimbursed for section 213(d) medical expenses incurred during the plan year.

(4) The debit card is automatically cancelled when the employee ceases to participate in the health FSA.

(5) The employer limits use of the debit card to

(i) Physicians, dentists, vision care offices, hospitals, other medical care providers (as identified by the merchant category code);

(ii) Stores with the merchant category code for Drugstores and Pharmacies if, on a location by location basis, 90 percent of the store's gross receipts during the prior taxable year consisted of items which qualify as expenses for medical care described in section 213(d); and

(iii) Stores that have implemented the inventory information approval system under paragraph (f).

(6) The employer substantiates claims based on payments to medical care providers and stores described in paragraphs (d)(5)(i) and (ii) of this section in accordance with either paragraph (e) or paragraph (f) of this section.

(7) The employer follows all of the following correction procedures for any improper payments using the debit card—

(i) Until the amount of the improper payment is recovered, the debit card must be de-activated and the employee must request payments or reimbursements of medical expenses from the health FSA through other methods (for example, by submitting receipts or invoices from a merchant or service provider showing the employee incurred a section 213(d) medical expense);

(ii) The employer demands that the employee repay the cafeteria plan an amount equal to the improper payment;

(iii) If, after the demand for repayment of improper payment (as described in paragraph (d)(7)(ii) of this section), the employee fails to repay the amount of the improper charge, the employer withholds the amount of the improper charge from the employee's pay or other compensation, to the full extent allowed by applicable law;

(iv) If any portion of the improper payment remains outstanding after attempts to recover the amount (as described in paragraph (d)(7)(ii) and (iii) of this section), the employer applies a claims substitution or offset to resolve improper payments, such as a reimbursement for a later substantiated expense claim is reduced by the amount of the improper payment. So, for example, if an employee has received an improper payment of \$200 and subsequently submits a substantiated claim for \$250 incurred during the same coverage period, a reimbursement for \$50 is made; and

(v) If, after applying all the procedures described in paragraph (d)(7)(ii) through (iv) of this section, the employee remains indebted to the employer for improper payments, the employer, consistent with its business practice, treats the improper payment as it would any other business indebtedness.

Full Documents – Items above are starting on page 21.

http://www.irs.gov/irb/2007-39_IRB/ar14.html



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