



State of Wisconsin
Department of Employee Trust Funds
Robert J. Conlin
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931

1-877-533-5020 (toll free)
Fax 608-267-4549
etf.wi.gov

Correspondence Memorandum

Date: January 19, 2016
To: Group Insurance Board
From: Jessica Rossner, Program Manager-Employee Reimbursement Accounts
Subject: Healthcare Flexible Spending Account (FSA) Debit Card 2014
Unsubstantiated Claims

This memo is for informational purposes only. No Board action is required.

The Employee Reimbursement Accounts (ERA) Program is overseen by the Employee Trust Funds (ETF) Board. The Group Insurance Board (Board) receives updates related to the ERA Program due to the program's direct relationship to the payment of member premium under the state health insurance program and the payment of services using health care flexible spending accounts.

This memo provides background specific to ETF's efforts to resolve 2014 unsubstantiated claims under the Healthcare FSA program.

Background

In 2014 the Department of Employee Trust Funds reported to the ETF Board on the status of efforts to resolve several issues involving the former third-party administrator of the Healthcare FSA program. One of those issues concerned 2012 and 2013 unsubstantiated claims of participants in the program. ETF consulted with outside tax counsel as part of the effort to resolve the unsubstantiated claims issue and the other issues regarding this program.

ETF found it necessary to develop a response to a remaining issue concerning the FSA program and the former third-party administrator, specifically 2014 unsubstantiated claims. Once again, ETF sought the advice from our outside tax counsel. This memorandum provides an overview on the action taken by ETF to address that issue.

According to the IRS guidelines, participants are required to substantiate all claims made with an FSA debit card to prove the claims are eligible FSA expenses.

Substantiation consists of providing documentation, such as an itemized statement, detailed receipt, or an explanation of benefits verifying the claims are eligible FSA

Reviewed and approved by Lisa Ellinger, Director, Office of
Strategic Health Policy

Electronically Signed 2/8/16

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expenses. The IRS regulations provide specific guidance to the plan sponsor if a participant should fail to substantiate their healthcare FSA debit card claims.

IRS regulations require several steps to be taken in a particular order, such as offsetting the claim with other valid claims, demanding repayment of the overpayment, withholding from the participant's paycheck, and imputing income, for FSA debit card claims that are not substantiated.

On the basis of advice of tax counsel and ETF's own evaluation of the IRS guidance to resolve the 2014 unsubstantiated health FSA debit card claims, ETF concludes:

- An offset approach is not possible for the 2014 unsubstantiated claims because the error did not occur within the same plan year as an offset would occur.
- Several written demands for repayment were made by WageWorks, TASC, and ETF. A final deadline of June 15, 2015 was established for participants to either provide substantiation or make payment for the claims to the plan.
- Due to the State Transforming Agency Resources (STAR) project, Benefit Administration System Project (BAS), shortage of personnel resources and administrative burden, the ability to suppress the 2014 unsubstantiated healthcare FSA debit card claims by the end of the 2015 payroll periods by means of withholding from the participant's paycheck method, were extremely impracticable, if not impossible.

The plan sponsor has the authority to directly impute income to the participant through the administration of plan provisions and necessary compliance requirements under the Internal Revenue Code. As a last resort, the employer, via W-2 form, must impute taxable income to the participant for the amount of the unsubstantiated healthcare FSA debit card claims incurred.

On November 11, 2015 payroll processing centers and employers were instructed to account for 2014 uncollectible amounts by imputing income on the employee's 2015 W-2 form. A total of 1,005 employees with unsubstantiated claims were identified.

ETF staff are working with the current FSA administrator, TASC, to implement procedures for 2015 and 2016 unsubstantiated claims. We believe the procedures under discussion will provide ETF, payroll processing centers and employers with the necessary tools to address such claims for those two years and beyond.

Staff will be at the Board meeting to answer any questions.