McGraw Wentworth

SPECIAL Alert

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In This Issue

In this fifth issue of the McGraw Wentworth Special Alert for 2006, we will review guidance issued by the IRS that provides more details on using debit cards with an Health Reimbursement Arrangement (HRA) and Flexible Spending Accounts (FSAs).

Many employers offer the debit card technology to allow their plan participants immediate access to funds in their account. More and more organizations are adding this feature each year.

The guidance provides situations where the only documentation that is required can be collected through the debit card transaction. The guidance also clarifies using the card for dependent care expenses and additional claim substantiation requirements.

We welcome your comments and suggestions regarding this issue of our Special Alert. For more information on this article, please contact your Account Manager or visit the McGraw Wentworth web site at www.mcgrawwentworth.com.

"New Guidance on Debit Cards"

Recently, the IRS released Notice 2006-69 to provide additional guidance on claim substantiation requirements for Health Reimbursement Arrangements (HRAs) and/or Flexible Spending Accounts (FSAs).

The notice addresses three key topics:

- New circumstances when claims can be automatically substantiated when a debit card is used.
- Clarification on how the debit card can be used to pay for dependent care expenses under an FSA.
- Additional claim substantiation guidance that applies to all claims under HRAs and FSAs, even if the debit card is not used.

The new guidance is especially useful for employers that have added, or are considering adding, the debit card option to their FSA or HRA. The 2006 McGraw Wentworth Mid-Market Benefit Survey indicated that 23% of survey respondents offered the debit card with their HRA or FSA. The guidance provides additional opportunities for "auto adjudication", which means the processing for certain transactions will not require follow-up paperwork as part of the claim process.

This Special Alert will address the all the key areas covered by the new IRS Notice.

Auto Claim Substantiation with Debit Card

The IRS officially blessed the use of debit cards with HRAs and FSAs several years ago. They determined under what circumstances a claim could be substantiated without any additional paperwork, except for the information provided with the debit card transaction.

The following situations qualified for auto adjudication and did not require any additional information from the plan participant:

1. The debit card is used for a payment to health care provider and the dollar amount exactly matches a copayment amount of the plan.
2. A recurring expense that the participant has provided substantiation for in the past. For example, a $40 copay for a covered visit to a counselor. The $40 charge is paid every other week and once the initial

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Notable Thoughts

Don't judge each day by the harvest you reap, but by the seeds you plant.

Robert Louis Stevenson (1850-1894)

claim is substantiated, then the matching reoccurring copayment is auto-substantiated.

3. The provider substantiates the charge is for a medical expense at the time of service.

If any of the above situations are met, the participant can use the debit card and not provide any additional information to complete the claim. If the debit card is used and none of the above circumstances are met, the participant needs to follow up with the claims payer with the details of the claim to complete the claim process.

Claim substantiation is required for all claims paid by either an HRA or FSA. The new guidance provides additional situations where the information collected with the debit card transaction is enough to substantiate the claim.

The 2003 guidance allowed plans to "auto-adjudicate" claims with dollar amounts that matched any plan flat copay amount and the merchant code of the debit card machine indicated a health care provider. However, this could be problematic if debit card users purchased more than one service. If the amount of the debit card transaction did not exactly match a plan copay, the participant needed to submit the claim information. It is not uncommon for individuals to fill more than one prescription at the pharmacy. Unless the pharmacy was willing to scan each transaction separately, the participant would have to follow up with the claim verification paperwork.

The new guidance allows automatic substantiation for certain card transactions involving multiple co-payments at merchants or service providers with health-care-related merchant category codes. To qualify, the dollar amount of the transaction must equal an exact multiple of the co-payment for the specific service (e.g., a prescription drug co-payment) under an accident or health plan of the employer covering the participant, up to a maximum of "five times" the co-payment amount. The guidance applies similarly to plans with different co-payments for the same benefit (e.g., tiered co-payments for prescription drugs). If the "five times" limit is exceeded, the debit card can still be used to pay the claim, but the employee must later submit paperwork to the administrator to substantiate the expense. The Notice gives several examples of an individual with a $5 generic and a $10 brand name prescription copay. If an individual fills 5 brand name prescriptions and $50 is charged to a medical merchant code, the claim is automatically substantiated. If the individual filled 6 brand name prescriptions for $60, that transaction would exceed the "five times" limit, so the debit card could be used but the individual would need to submit receipts to the claims payer to complete the claim.

The guidance notes that the plan's co-payment schedule must be independently verified by a third party claim payer with the employer. It is not sufficient to have the copayment schedule verified by the employee.

The guidance also provides a method under which cards can be used to purchase qualifying Over The Counter (OTC) drugs and prescriptions with automatic substantiation, even at merchants without healthcare-related merchant category codes. This was another challenge with automatic substantiation. Many pharmacies also are retailers. Therefore, individuals would fill a prescription at K-Mart or Target and the merchant code would indicate "retailer." In this situation, the employee would need to submit receipts to verify the transaction was for a medical expense. The new guidance allows a claim to be paid for a merchant without a health care-related code providing the merchant has an inventory information approval system in place to ensure that cards are used only for eligible medical care expenses.

This sounds more complicated than it actually is. Many retailers use an electronic system to monitor inventory. The systems are electronically maintained by scanning the SKU (Stock Keeping Units) barcode. The information associated with a specific SKU code is enough to verify if

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the expense would be considered an eligible expense. If a merchant has the SKU technology, the system can approve the use of the card only for eligible medical care expenses. If an individual wants to purchase qualifying medical items and other items, the transaction will only be approved on the debit card for the items with the qualifying SKU. The additional amount due for the non-medical items will have to be paid out of the individual's pocket. This will result in a split-tender transaction.

The IRS requires that employers, whose health FSA or HRA debit cards are programmed to work with such an inventory system, be able to produce auditable records of all transactions. Therefore, your organization should verify with your claims payer and debit card vendor that you will be provided records of transactions that you can access if ever needed in an audit situation.

Debit Cards and Dependent Care Accounts

The new guidance discusses the ability for the debit card to be used for dependent care expenses. It was always assumed the card could be used for these expenses, yet the IRS never formally addressed the situation.

The guidance verifies the debit card can be used for dependent care expenses, but the process is a little more complicated than with medical expenses. These are some of the situations your organization may encounter:

- Not all vendors have the ability to process debit card transactions. If your employee uses an in-home daycare, it is unlikely the provider will have the ability to process a debit card transaction.
- Your plan cannot reimburse for an expense until the expense is incurred. It is pretty common to pay for daycare expenses in advance. If you pay your day care provider bi-weekly, the expenses have not been incurred until the end of the two week period. However, typically the payment is made at the beginning of the two week period. The guidance describes the possibility of using the previous two weeks of expenses when using a debit card. In that example, an individual would pay for two weeks of day care. Once the next two week payment is due, the debit card could be used and the dates of service reported would be the previous two weeks to meet the incurred requirement. This in theory is the same process that individuals use when submitting claims manually. Once the provider is paid, the claim is submitted to the vendor and the vendor cuts the check when the expense period has ended.

- The guidance allows automatic substantiation of recurring card transactions involving a previously approved provider and dependent care service period, as long as the amount does not exceed the amount previously substantiated.
- It is important to remember, with dependent care accounts, that the account can only reimburse funds up to the account balance. As a practical matter, if the dependent care vendor swipes the debit card and the amount in the account is less than the total charged, the entire transaction will be declined. This process will frustrate employees until they figure out a way to make sure they are not requesting more with the debit card than is available in the account.

The official guidance is welcomed by employers that offer debit card processing of dependent care expenses. However, these transactions may be more difficult than medical expense transactions. It will be important to clearly address the issues outlined above with employees in order to set reasonable expectations.

More Claim Substantiation Guidance

The IRS has also provided guidance on two additional substantiation issues that apply to all health FSAs and HRAs. These two issues apply to claims processed manually or through the debit card:

- If an employer receives an Explanation of Benefits (EOB) letter or similar information from an insurer or other independent third party indicating the date of a Code Section 213(d) medical care expense and the employee's responsibility to pay for the

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expense (i.e., as co-insurance or to satisfy a deductible), the claim is fully substantiated. In some cases, the claims payer for the medical plan is also the claims payer for the FSA. Many vendors have the ability to automatically transfer the required information between the payment systems. In addition, the ability to access information electronically has expanded dramatically over the last five years. Your health plan vendor may be able to communicate with your FSA claim payer to expedite the reimbursement process.

If this process is implemented, employers at open enrollment should require employers to verify they won't seek reimbursement elsewhere for any expenses that the healthcare FSA or HRA reimburses.

- This guidance also expressly provides that expenses cannot be reimbursed based on an employee's self-substantiation. For example, a plan may not reimburse expenses based solely on a participant's e-mail describing the type of expense, the amount, and the date without appropriate third-party substantiation. This is not a new requirement and claim payers should require provider documentation that the claim is for an eligible medical expense.

The IRS guidance is welcome, but many administrators have already taken practical measures to address these issues.

Conclusion

The new guidance on debit card processing increases the number of claims that can be auto adjudicated. When a debit card is used as a payment mechanism, the claim must still be substantiated.

The IRS has outlined several situations where the debit card transaction can meet the substantiation requirement. When the IRS requirements are met, those claims are substantiated with the debit card transaction and no additional documentation is needed from the participant.

Many employers are investigating the possibility of adding the debit card as a processing option with their spending accounts. Employers that have added the debit card report FSA participation increased when the card option was added.

In general, administrative costs are slightly higher when a debit card is added and the claim process becomes a bit more complicated. However, with a capable vendor and good communication, the debit card technology can improve your organization's flexible spending account process.

If you have any questions regarding this guidance, please contact your McGraw Wentworth Account Manager. MW

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