

Quarterly Review

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From the Desk of the Editor

Greetings to our clients and friends and welcome if this is your first issue of the Quarterly Review.

With the delivery of the State of the Union Address and the Administration's budget proposals released we can gauge wind direction if not speed. We dodged a bullet as the President rejected the tax advisory commission's recommendation to tax or limit employer-provided tax benefits (whew). However, it is clear that health care cost containment, HSAs, and tax equality remain top priorities. Ray Ranthum, Special Assistant to the President for Economic Policy and architect of the President's HSA Expansion Proposal, has stated publicly that the President wants to level the playing field for individuals without access to healthcare at the workplace via tax credits/above the line deductions. The President's budget includes proposals to expand HSAs, and simplified savings vehicles were again proposed. Missing were any corresponding proposals, as the Tax Reform Panel had suggested, to eliminate other tax favored accounts such as HSAs or FSAs – another bullet dodged. We can thank ECFC for quality lobbying on our behalf and John Hickman (our outside counsel) in particular who testified for the ECFC Legislative Council (and we members) before key legislators and the Administration.

In this issue of the **QR**, our feature article is fittingly our IRS Regulatory update. Their business plan cycle ends 6/30/06 and there remain some key projects yet to be finalized before the President's new initiatives and proposals are added. We recently acquired a licensing agreement with Employee Benefits Institute of America Inc. (EBIA) to begin reprinting in this newsletter some past EBIA articles. Those selected will be germane to and representative of the questions you have posed to us over the quarter for interpretation and/or opinion. As many of you know, EBIA produces a quality array of resource tools that we have utilized in Standards and Practices for many years.

There are numerous other articles to keep you abreast of happenings in the benefit field, including a good article on Security. I recently heard someone say that HIPAA is job security for IT and Legal staff in a post Y2K world – how true.

Enjoy! Trish Neely

Fringe Benefits Management Company
3101 Sessions Road Tallahassee, FL 32303
850-425-6200 1-800-872-0345 FAX 850-425-6220

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A Perspective from the Hill

Robert McKnight, Senator; Senior VP

US House Majority Leader John Boehner (R. Ohio) is poised to become one of the most powerful members in the United State's Congress. Perhaps most important to the benefits administration industry, he has had a long interest in federal legislation dealing with employee benefits. For the last 5 years, Congressman Boehner has chaired the powerful House Committee on Education and Workforce that has initiated a number of bills dealing with employer sponsored benefit programs.

But now that he has replaced Congressman Delay (R. Texas) as House Majority Leader, he will enjoy unbridled political power. Congressman Boehner relates well to the business community because he was in sales with the plastic and packing industry. Also he is able to work much better than Congressman Delay with the Minority Party, the Democrats. To be clear however, Congressman Boehner is a consistent conservative, who is expected to carry much of President Bush's legislative agenda, including continued support of high deductible Consumer Driven Health Plans and Health Savings Accounts. He was the author and prime force behind the new retirement reform legislation recently enacted into law.

Although there is speculation that the Democrats may regain the majority in the House of Representatives, the election of Boehner as House Majority Leader makes that less likely because of his popularity with powerful industry

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lobbyists. He is considered one of the most successful fundraisers for congressional campaigns. Unlike Delay, Boehner appears to be a likely candidate to replace Speaker of the House Dennis Hastert (R. Illinois) when he retires.

Remember Majority Leader Boehner's name...I predict we will be hearing a lot about him in the future.

Featured Article

IRS Business Plan Progress

Trish Neely, CFCI

The IRS Business Plan year runs from July 1 – June 30 so we are just months away from the due date for the 254 projects listed on the 2005-06 Priority Guidance Plan. The plan encompasses all Treasury and IRS issues, however, we follow only the twenty or so that in any given year pertain to health and welfare programs, defined contribution plans and tax law for café plans.

On 3/6/06 the Department of Treasury issued its First Periodic Update of the Plan. As you know through past Quarterly Review or Benefit Alert distributions, guidance has been issued to date related to Roth retirement plans, the interaction of the grace period for HFSA's and HSA's, and the much needed HSA eligibility guidance. However, some significant issues remain outstanding as of this writing. From the forty-four-page update, I will begin and also comment upon the several projects most pressing for plan sponsors and administrators. They are listed in the report as **original** projects (I presume that's because they have been on the business plan for awhile now):

Original Projects 6 & 9:

Guidance on debit cards, including employer provided medical expense reimbursements and qualified transportation benefits.

We know from Kevin Knopf, Attorney with Treasury and one of the primary authors of the 2003-43 card ruling, that the new guidance will address auto-adjudication of multiple co-pays and will also address the current requirement to tie an employee with a specific health plan and co-pay amount. Knopf is less forthcoming with any other details. As he explained at the recent ECFC

Conference, the closer Treasury is to issuing guidance the less able they are to speak of it.

It will be interesting to see if DCAP plans will be addressed. Although Harry Beker has stated more than once that he sees no way around using the Card without violating the primary tenant of § 129 – that expenses must be incurred before they are reimbursable, many administrators and card vendors are using electronic payment cards with their DCAP plans. We would welcome this addition for our DCAP customers.

Knopf did drop a bomb-shell on plan sponsors and administrators whose debit card practices do not comply with the ruling. The IRS has created a Lead Development Center manned with a few agents who are very anxious to begin auditing plans with abusive practices. And according to Knopf, they are not going to be lenient on abusers!

Note: the EZ Reimburse® Mastercard® Card is fully compliant.

Original Project 8: Proposed regs on Code § 125 café plans.

When Harry Beker first started talking about this project several years back he referred to **Final Regs**. They were close to being issued two years ago but were shelved to make way for the rule making and guidance needed to make HSA's a reality. At the March 2006 ECFC Conference, Beth Purcell, Assistant Chief to Beker and primary author of the new proposed regs confirmed that the old proposed regs will be withdrawn and will be updated, enhanced, and consolidated into new proposed regs. Unfortunately, this round will not include any amendments to the §125-4 Change in Status rules – they will be incorporated as is.

Why proposed rather than final regs? According to Purcell, "To give the public a chance to comment and make suggestions."

Keep those cards and letters coming!

General Tax Issues, Project 21: Regs under Code §4980G on employer comparable contributions to HSA's.

One of the clarifications we expect to see addresses the question of what constitutes a

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cafeteria plan. Can an employer avoid HSA comparability rules by creating a simple POP plan or must there be more than payroll activity? We believe the intent was to require a full plan; however, in the absence of guidance, some plan sponsors are using POP plans as their engine. This is far simpler if it's approved.

Other noteworthy projects still pending:

Employee Benefits, Project 20: Updated regs on the definition of HCE under Code § 414(q).

Employee Benefits, Project 21: Comprehensive final regs regarding the limitations on benefits and contributions under Code § 415.
Proposed regs published 5/31/05

General Tax Issues, Project 1: Regs under Code § 21 regarding credit for household and dependent care expenses.

General Tax Issues, Projects 16 & 17: Proposed regs regarding the definition of dependent and the release of a claim for exemption for a child of divorced or separated parents. This is to correct and/or clarify some WFTRA problems.

The full forty-four page document can be found on the Internet at www.irs.gov – enter Priority Guidance Plan in the key word locator; or copies may be obtained by calling Treasury: (202) 622-2960.

Public Employers, GASB-43 and GASB-45

Patrick Peters, Assist. V.P., FBMC

Public employers find themselves having to comply with the new GASB standards.

GASB-43 requires that the liability for Other Post-Employment Benefits (OPEB) must be reflected on the employer's Balance Sheet.

GASB-45 requires that the expenses associated with the OPEB liability must be reported on the employer's Income Statement.

The GASB standards do not require that the liability for OPEB be funded. However, if it is not funded, that creates issues for an employer with respect to their ability to borrow money. Bond-

rating agencies are likely to take unfunded liability into account when assessing the financial condition of an entity. Further, if the bond-rating drops, then the entity will have to pay more to borrow money.

The new GASB requirements pose significant challenges for public employers to appropriate funding for this new liability. Pay-as-you-go for OPEB will go the way of the dinosaur.

Patrick Peters, Assist. Vice President of FBMC, will facilitate a discussion at the State and Local Government Benefits Association (SALGBA) Conference in Kentucky on Monday, May 1st on this and other topics, and suggest potential approaches to meet the new GASB requirements.

News Briefs

Tina Bischoff, FBMC Compliance Officer, CFCI

Proper Substantiation Or IRS Penalties

A great deal of interest in FBMC's stored-value card services has been generated by the featured article in FBMC's *Quarterly Review* (January 2006) entitled "Thinking About Implementing an Electronic Payment Card?"

To recap that article, the employers/plan sponsors allowing reimbursement plan participants to pay for eligible expenses with an electronic payment card are faced with a fundamental question — *what are the IRS substantiation requirements associated with the electronic payment card process?*

To emphasize the importance of proper substantiation for electronic payment card transactions, Kevin Knopf, Treasury Attorney and an author of the electronic payment card ruling (Rev. Rul. 2003-43), informed plan sponsors and benefits administrators at a recent ECFC Conference that the IRS has recently created a Lead Development Center to begin auditing plans for compliance with the Ruling's substantiation requirements.

FBMC's EZ Reimburse[®] MasterCard[®] Card complies with Rev. Rul. 2003-43. To provide general information concerning the law in this area, FBMC recently obtained a white paper from the law firm of Alston & Bird LLP entitled *Overview of*

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Electronic Payment Card Adjudication and Substantiation Requirements.

The contents of FBMC's featured article and the white paper from which it was excerpted should not be construed or relied upon as legal advice but rather represent our view that 100 percent of all claims for health and dependent care reimbursement arrangements must satisfy the applicable adjudication and substantiation requirements under Rev. Rul. 2003-43.

To obtain a copy of the January 2006 issue of the *Quarterly Review*, visit FBMC's website at <http://www.fbmc-benefits.com>. To obtain a copy of the white paper authored by John R. Hickman, Esq. and Ashley Gillihan, Esq. of Alston & Bird LLP, visit FBMC's display at the State and Local Government Benefits Association (SALGBA) Conference in Kentucky on Monday, May 1st.

Georgia's Assessment Bill

In March 2006, a bill tried to make its way through the Georgia Legislature that proposed reforming the Georgia Assignment Pool system to pay for the medically uninsured. The bill would do this by imposing assessments on TPAs (among others) that paid or processed claims for self-funded health plans. The bill did not succeed.

IRS Publication 503 (Child and Dependent Care Expenses for Tax Returns)

We often receive inquiries from plan sponsors on whether IRS Publication 503 can be relied upon to provide guidance to dependent care FSA participants. Yes and no! The IRS issues this publication annually to assist taxpayers in determining whether they qualify for the dependent care tax credit when filing their tax returns. For this reason, participants in a dependent care FSA plan are cautioned **not** to rely on this publication completely.

For example, when taking advantage of the dependent care tax credit, the 2005 IRS Pub 503 states that a taxpayer is allowed \$3,000 of employment-related expenses for one qualifying individual and \$6,000 for two or more qualifying individuals. However, under the IRS regulations governing an employer/plan sponsor's dependent care FSA plan, participants may only exclude from income employment-related expenses, whether for one or more qualifying individuals, in an amount no

greater than their tax filing status for that year. This means that taxpayers filing as single, head of household, and married, filing jointly for the 2005 tax year would each be eligible to set aside up to \$5,000 in a dependent care FSA plan as long as all other plan requirements are met.

On the other hand, a couple of new items were added to the 2005 IRS Pub 503 that do impact dependent care FSA plans as follows:

- internet schools have been added to the list of institutions that do not qualify as schools, and
- payments for employment-related dependent care, made to a *spouse* or to the *parent of a participant's qualifying child who is under age 13*, are not reimbursable.

For a copy of the 2005 IRS Pub. 503 visit: <http://www.irs.gov/pub/irs-pdf/p503.pdf>.

GUEST ARTICLES

Tina Bischoff, FBMC Compliance Officer, CFCI

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Can our company's health FSA reimburse a doctor's monthly fee that is payable whether or not the patients visit the office?

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QUESTION: A participant in our company's health FSA told us that her doctor has started charging his patients a monthly fee that is payable whether or not the patients visit the office-there is no additional charge for actual office visits. She has asked whether our health FSA can reimburse this fee. What should we tell her?

ANSWER: Generally, fees of this type are not reimbursable. In our view, such fees are like insurance because they are payable whether or not medical care is provided. Thus, they fall under the "no reimbursement of insurance premiums"

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rule that applies to health FSAs and should not be reimbursed. Another variation on this type of fee is the “royal treatment program,” under which patients receive preferential “extras” from their doctors in exchange for a fee (e.g., priority when scheduling appointments, a monthly newsletter, a special waiting room, etc.). Fees for such programs generally shouldn’t be reimbursed either-in addition to being insurance premiums, the payments would not be for medical care. (For an expense to be reimbursable under a health FSA, it must be for “medical care” as defined in Code Section 213(d)-additional requirements must also be met.) The same is true of a monthly retainer fee that a patient must pay in addition to any co-pays, deductibles, or other charges for office visits. (Some doctors have imposed these types of fees in response to reductions in the amounts being paid by insurance companies and HMOs for routine care.)

Note that there could be variations on these programs under which some services might be reimbursable, depending on how the program is structured (for example, a fee might include payments that can be separately allocated to services that are for medical care). And don’t put too much stock in the particular name given to the type of fee (e.g., retainer fee, concierge fee, etc.)-these terms may mean different things for different providers. Consequently, it’s important to determine exactly what services are involved before deciding whether to reimburse part of a fee-you may need to ask the participant for additional substantiation.

For more information, see EBIA’s Cafeteria Plans manual at Sections XX.E (“Expenses Reimbursed Must Be for Medical Care”) and XX.L (“Health FSAs Cannot Reimburse Insurance Premiums”).

FBMC Comment: This article caught our eye. It is (and has been) FBMC’s position and practice that health FSA participants may not be reimbursed for the cost of retainer fees, maintenance fees or any other fee imposed by a physician, dentist or other qualified healthcare professional when that fee is not for medical care.

DOL Advises That Flex Credits for Group Health Plans Must Be Continued During FMLA Leave

(This copyrighted article originally appeared in the 03/02/06 EBIA Weekly and is reproduced with the permission of EBIA.)

[DOL Opinion Letter FMLA 2006-3-A (Jan. 31, 2006)] For a copy:

http://www.dol.gov/esa/whd/opinion/FMLA/2006/2006_01_31_3A_FMLA.pdf

When an employee takes a leave of absence under the Family and Medical Leave Act (FMLA), an employer generally must maintain the employee’s group health plan coverage at the same level and under the same conditions as if the employee had remained actively employed. This means, among other requirements, that the employer cannot require an employee on FMLA leave to pay more for coverage than the employee would have paid had he or she remained actively employed. Complying with this requirement is reasonably straightforward when an employer directly subsidizes coverage under a group health plan. But what if the subsidy is provided in the form of “flex credits” under a cafeteria plan?

In this DOL Opinion Letter, an employer provided a fixed monthly amount (called an “allotment”) to employees who were participating in its cafeteria plan, which they then used to pay the premiums for group health plan coverage. Employees had the option to apply any remaining balance to the cost of dental, disability, or life insurance coverage or to receive that amount in cash. Noting that the requirement to maintain group health plan coverage on the same conditions applied “whether or not [the coverage is] provided through a flexible spending account or other component of a cafeteria plan,” the DOL concluded that employees taking unpaid FMLA leave “must have that portion of their cafeteria plan allotment allocated to group health insurance (including dental) premiums paid by [the employer] in the same amount as paid prior to the start of FMLA leave.” Furthermore, because the employer paid for group health insurance coverage while employees were working, it could not recover such payments from its employees when they returned to work after FMLA leave.

EBIA Comment: Employers who are using flex credits for their group health plans will find this guidance helpful-it’s the first we’ve seen that directly addresses the proper handling of flex credits when a cafeteria plan participant goes on

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FMLA leave. Although not an issue in this case, similar principles would likely apply when employees allocate flex credits to health FSAs. In contrast, note that an employee's entitlement to benefits other than group health coverage (such as disability and life insurance in this case) during a period of FMLA leave depends on the employer's policy for providing such benefits when the employee is on other forms of leave. For more information, see EBIA's Cafeteria Plans manual at Section XIV.O ("FMLA Leaves of Absence (Exception #13)") and EBIA's Group Health Plan Mandates manual at Section XVII.D ("Paying for Coverage During FMLA Leave").

FBMC Comment: Though *DOL Opinion Letter FMLA 2006-3-A (Jan. 31, 2006)* provided guidance to a specific taxpayer, it also offered insight into how the Department of Labor views the treatment of flex credits under a cafeteria plan when an employee takes a leave of absence under FMLA. Many plan sponsors, including FBMC, welcome this new information.

2006 Security Evaluation

Kedra Baumgardner, Security Officer

Introduction

Trish Neely, Chief Compliance Officer

I recently heard a lecture by Peter Marshall, CEO of The Identify Guardian, a firm providing risk management solutions to companies who specialize in employee benefits. I was stunned by some statistics Peter threw out to the audience - for example: one in every 25 adults is the victim of identity theft, to the tune of \$57 billion annually. More than half (51%) of identify thefts occur at the workplace. Of this number, 90% of workplace thefts involve fellow employee payroll or employment records, the remaining 10% involve customer lists or records. And yes, we do maintain reasonable safeguards to protect your employee data. I asked Kedra Baumgardner, AVP Corporate Governance and also our Security Officer to prepare the following article for you to describe the annual Security Evaluation that she conducts in order to comply with FBMC's privacy and security policies as well as HIPAA's requirements:

Many employers/covered entities do not know that the HIPAA Security Rule in Section 164.308(a)(8) requires covered entities to perform a periodic *technical and non-technical evaluation*. For FBMC, conducting a security review is old hat –

we have been securing and guarding customer data for years with very specific policies and procedures in place. However, HIPAA expanded as well as formalized the process for us. Since data security and identity theft is a hot topic at most conferences or seminars these days, (and because Trish requested) I am sharing with you some of the procedures we follow.

Annually, I conduct a three-part evaluation – in fact I am in the midst of that evaluation as I write this. My evaluation includes:

1. Technical evaluation – a review of system audit and event logs, reports and other documents to detect security issues or concerns.
2. Non-technical evaluation – an informal walk-through and visual inspection of audit logs and documentation to verify that policies and procedures are being followed.
3. Security rule evaluation – an assessment of required policies for the standards specified in the HIPAA Security Rule.

Since FBMC undergoes an annual SAS70 review, the items addressed as part of the technical evaluation are not as comprehensive as would otherwise be required. The smaller scope eliminates duplication that would needlessly tax our internal resources and provides me the opportunity to focus more closely on those items being addressed. By way of example, I review and confirm that:

- Backups are being performed, logged and rotated off-site.
- Backup tapes are periodically tested to ensure that data can be recovered.
- Access to database applications is restricted.
- Disaster recovery testing is being performed annually.
- Firewall logs are being reviewed.

To determine the non-technical items to evaluate, a review of all security-related policies and procedures was done. For example, if we have a policy that says all FBMC employees will log off at the end of the day, an item was added to conduct an after-hours walk through to visually inspect each workstation. Some of the other non-technical items we review are:

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- A walk through to determine if laptops are being secured with a laptop lock after hours.
- A walk through to determine if PHI is being properly secured after hours.
- A walk through to ensure that all restricted areas are not accessible after hours.
- A review of the Visitor Control log to ensure that our guests are being properly signed in and out.
- A review of the *facility access report* to ensure that FBMC employees have only the minimum access necessary to do their jobs.
- A review of Sonitrol security logs to assure the building perimeter is secure at all times.

The security rule evaluation is simply a listing of all the standards listed in the HIPAA Security Rule (as applied operationally to one's organization). Each item is reviewed to ensure that FBMC is in compliance with the specifications.

To make the evaluation easier to conduct and record the results, I've created a template document. The template contains a table that has columns to record the item number, a description, how to evaluate that item and the evaluation results.

Once the evaluation has been completed, action plans are created for any item with exceptions. An FBMC employee is assigned to each item to ensure that item is not only corrected, but that policies or procedures are changed to prevent the exception from reoccurring.

Like everything HIPAA-related it seems daunting, but there are some tools available to make it easier. Feel free to email if you would like information about resources. The important thing is to just get started. Kbaumgardner@fbmc-benefits.com

Vista Management Company Undergoes NASD Examination

Holly Hance, VMC Compliance Officer

In early March the National Association of Securities Dealers (NASD) performed their 3-year cycle examination of Vista Management Company (VMC). The NASD is the self-regulatory organization (SRO) that monitors and enforces

the federal securities laws governing registered broker dealer firms of which VMC is a member.

They review our Written Supervisory Procedures, which include among other things, our internal controls that govern the registered representatives, and their conduct with the customers. They examine our communications with the public, our compliance with NASD continuing education requirements, and a complete review of all of our back office activities. We provide to them VMC's audited financials, our FOCUS Reports, and our monthly Net Capital Computations, and any other books and records they request.

We are awaiting the formal report from the district director of the NASD in Boca Raton; however informally we know everything was in order and no exceptions or violations were found.

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