United States
Office of
Personnel Management
The Federal Government's Human Resources Agency

Retirement and Insurance Programs
Benefits Administration Letter

Number: 03-306

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Subject: Flexible Spending Account (FSA) Program: Payroll Specifications

The Federal Flexible Benefits Plan ("FedFlex") enables eligible employees to pay for certain benefits with pre-tax dollars. The initial FedFlex benefit, Health Benefits Premium Conversion, was implemented in October 2000. We are now enhancing FedFlex to include a second pre-tax benefit for Flexible Spending Accounts (FSAs) which will be implemented July 1, 2003.

On January 9, 2003 you received Benefits Administration Letter 03-301 giving preliminary information regarding the Flexible Spending Account program. This Letter provides agency payroll offices with additional guidelines for the deduction and remittance of FSA allotments. These guidelines are designed to provide the information you will need to make software or other system enhancements necessary to implement correct payroll processing for this program.

FSA elections made by an employee are completely voluntary and must be made on an annual basis during the open enrollment period for the upcoming plan year. FSAs are not carried over from one plan year to the next. OPM selected SHPS, Inc. (SHPS) as the third party administrator for the FSA program.

Two FSAs will be offered to eligible employees:

- *A Health Care FSA [HCFSA]*, through which employees may use pre-tax allotments to pay for certain health care expenses that are not reimbursed by any other source and not claimed on the participant's income tax return. The maximum amount an employee may set aside in any tax year will be $3,000 and the minimum will be $250.
- *A Dependent Care FSA [DCFSA]*, through which employees may use pre-tax allotments to pay for eligible dependent care expenses. The maximum amount an employee may set aside in any tax year is $5,000 ($2,500 if the employee is married and filing a separate income tax return) and a minimum amount of $250.

Section 125 of the Internal Revenue Code, allows employees to pay for certain health and dependent care expenses with pre-tax dollars. As with Premium Conversion, employees may choose to make a voluntary allotment from salary to their FSA account; participants do not pay employment or income taxes on these allotments and their employing agencies also avoid paying employment taxes. Employees who voluntarily elect to participate will identify an annual amount of salary to be contributed to their FSA via SHPS. SHPS will translate these annual elected amounts into pay date allotments and request payroll office to deduct them and remit them for deposit into the employees' FSA accounts. Employees can draw upon their FSA accounts for reimbursement as they incur eligible expenses.

The Office of Personnel Management (OPM) will conduct an open season for enrollment in the Flexible Spending Account Program (FSA), beginning in mid May and running through June 20, 2003. This will be the first opportunity for most Federal employees to voluntarily allot pre-tax salary to a HCFSA or DCFSA.

The effective date of the FSA program is July 1, 2003. The initial plan year will end on December 31, 2003. Open enrollment for the first full plan year will take place concurrent with the FEHB open season in November/December of 2003. All future FSA plan years will be January 1 through December 31 and employees must re-enroll each year to be eligible.

Information on requirements specific to your agency payroll office (APO) will be determined by direct discussion between the APO and SHPS. They will be essentially identical to those currently in place for long term care (LTC) premium payments.

Throughout this letter, we use the term “employee” to mean an eligible Federal civilian employee. Employees who are eligible for FEHB coverage (even if not enrolled) are eligible to voluntarily elect an allotment for a HCFSA and a DCFSA. Additionally, employees in a temporary appointment of less than one year; and seasonal and intermittent employees are eligible to voluntarily allot money for a DCFSA. For more information on FEHB eligibility, please visit our website at http://www.opm.gov/insure/health/eligibility/index.asp. Annuitants and military personnel are not eligible for this program. Most employees of Executive Branch agencies, as well as employees of non-executive branch agencies that choose to participate will be eligible. When we offered premium conversion in 2000, almost all agencies that did not already have a program in place under independent compensation authority chose to adopt it for their employees.

The U.S. Postal Service, the Judiciary, and some bank regulatory agencies already offer FSAs to their employees and are not covered by FedFlex. Agencies that adopted FedFlex for premium conversion are eligible to adopt the FSA benefit as well.

Enrollment procedures

Employees will voluntarily enroll for HCFSAs and/or DCFSAs directly with SHPS, either on-line or through a toll-free call to a SHPS customer service representative. The enrollment will not be processed or approved by the APO or the human resources office. Thus, the FSA enrollment process is different from the Federal Employees Health Benefits (FEHB) and Federal Employees' Group Life Insurance (FEGLI) Programs but very similar to the Federal Long Term Care Insurance Program application process.

Communication of payroll office identifier

One of the items an employee will need to know to set up one or more FSA accounts is the payroll office identifier for his/her payroll provider. This identifier will be the basis for SHPS collection process. Since the FSA enrollment will not flow through APOs or human resources offices, employees must input their payroll office identifier on the enrollment. The payroll office identifier will be provided via a drop down menu on SHPSs web-based enrollment system. The payroll office identifiers to be included in the entire enrollment process are the same as those used by the Long Term Care Insurance Program. SHPS will be contacting APOs to ensure that the identifiers are accurate.

Billing file

For employees electing an FSA allotment, SHPS will forward to APOs a billing file containing all necessary information to make FSA allotments from payroll. This file will be transmitted in the format and on the schedule agreed upon by the APO and SHPS. At the APOs option, the billing file can either be a "change" file or a "full" file. A change file will include only new allotments, changes to allotments, and stop allotments, while a full file will contain complete allotment information for all enrollees. The billing file will be provided to the APO on the schedule agreed upon by the APO and SHPS.

The billing file will contain information such as:

- Name of employee (last, first, middle initial)
- Social security number of employee
- Payroll office number (PON)
- Amount of allotment
- A plan number indicating a HCFSA or DCHSA (by 1/1/04)
- Pay Period Dates
- One-character code, as follows:

  A - initial allotment
  C - change allotment amount
  D - cancel allotment
  N - no change in allotment amount (on full files only)

Amount to deduct

SHPS will calculate the amount of payroll allotment based on the total amount elected by an employee for one or both accounts. The total amount elected by the employee will then be pro-rated over the number of pay dates the employee has remaining in the Plan year. It is critical, therefore, that the APO verify with SHPS information about each pay date/payroll cycle it services.

The APO will reduce individual employee pay by the exact amount specified by SHPS on the billing file and remit that amount to SHPS. Therefore, you will not have to calculate the amount of FSA allotments.

Order of precedence

APOs will deduct FSA amounts in the order specified in their established rules of precedence. If an employee elects both a HCFSA and DCFSA, HCFSA elections must be placed before the DCFSA elections. Because employees agree to salary reduction via an allotment, we recommend they be placed in an order of precedence similar to that of premium conversion. Do not take any partial allotments.

IRS Limitations apply to DCFSAs on an Aggregate basis

The maximum DCFSA election for an employee is set at $5,000 by IRS law. This $5,000 limitation is the maximum pre-tax benefit for all dependent care programs available to the employee, including under programs other than FSAs. As a result, if an employee is receiving a child care subsidy pursuant to Public Law 107-67 Section 630, and the combined benefit to the employee exceeds the $5,000 limit, both the employee and the Agency will be responsible for tax on any aggregate amount that exceeds $5,000 ($2,500 if married but filing separately).

Unlike DCFSAs, there is no maximum HCFSA allotment specified by IRS law. While the maximum permitted under FedFlex is $3,000, an employee or spouse may have another FSA available through another employer plan. Thus, the aggregate HCFSA allotments may exceed the $3,000 FedFlex maximum.

Effective date of Plan year and initial allotment

For the initial Plan year that begins July 1, 2003, employees will not be eligible for reimbursement until the first allotment is received by SHPS. The first payroll allotment will be taken from the first pay date in July. For all future years, the plan will be effective from January 1 through December 31 and all eligible expenses incurred by an employee within the plan year will be reimbursable. This requires no action on the APOs part. The APO will simply allot what the billing file from SHPS says to allot. FSAs must be annually elected by employees. If an employee does not make an election during the open enrollment period of November/December of each year, his or her allotments will not continue into the new plan year.

This program was a major topic at last years Benefit Officers Conference in June 2002 and was discussed in the FEHB press release in September 2002. Payroll offices were again notified in January 2003 through Benefit Administration Letter 03-301. Because operation of the program will be patterned so closely to that of the Long Term Care Program, we expect no difficulties in having this program fully implemented on a governmentwide basis by the July 1, 2003 deadline. However, please let us know immediately if you anticipate any difficulty in implementing FSA allotments in July and include:

- specific information about the anticipated difficulties

- a date certain for implementing FSA allotments
- an agency contact and phone number that we may refer employees to for additional information.

If we do not receive notification from you within a week of transmitting this letter, we will assume that you will be prepared to implement effective the July 1, 2003.

Remittance of allotments and associated information

On each pay date, the APO will remit the payroll allotments to SHPS along with information supporting the allotments. The form of remittance, both the method by which payment is made to SHPS, and the format in which the allotment data is provided to SHPS, will be the methods patterned after LTC premium remittances and agreed upon by the APO and SHPS. At a minimum, the remittance file will contain information such as:

- Name of employee (last, first, middle initial)
- Social security number of employee
- Payroll office number (PON)
- Pay Period Dates
- Total amount remitted
- Reason for allotment not being made and date status was effective:
    - Death
    - Term/Retired
    - Separated from service
    - Transferred to another APO
    - Unrecognized SSN
    - Seasonal/Teacher
    - Unpaid Leave/Disability
    - Insufficient Funds Health Care
    - Insufficient Funds Dependent Care
    - Other

"All or none" deductions

If an employee salary is ever insufficient to cover the full amount for FSA allotments, you will deduct nothing at all for that period. You will not make a partial allotment at any time during 2003. If a salary allotment is missed, SHPS will freeze the account for all HCFSA expenses until allotments begin again or the situation is resolved through contact with the employee. DCFSA accounts will not be frozen because employees can only be reimbursed for amounts already in their accounts.

Any time an allotment is missed, SHPS will recalculate the allotment schedule such that the unpaid balance of the employee's annual election will be paid over the pay dates remaining in the calendar year. The previously scheduled allotment will be doubled unless a higher multiple is needed given the number of remaining pay dates. No action is needed on the part of the APO.

Reconciliation and reporting requirements

SHPS is solely responsible for making sure it receives the proper allotment for each enrollee. You are responsible for taking the allotments and timely remitting the amounts billed by SHPS, and assuring that the payment file total, together with any error or "kick out" file or reports balances to the total remittance requested by SHPS for the period.

Testing schedule

Testing of the specific billing files, remittance files, as well as electronic transmissions of these files, will begin in mid May, and continue through early June. Testing schedules will be established between each APO and SHPS.

The testing will:

- encompass the specific field data on the files,
- include cycles to allow for testing adds, changes, and deletes, as well as status change information, and
- ensure balancing of the remittance file.

The following is an *example* of a high-level testing schedule:

- May 5 - Initial test billing file from SHPS to APO - all adds
- May 15- Initial test remittance file from APO to SHPS - including status changes, missed allotment deductions, etc.
- May 28 Second test billing file from SHPS to APO - adds, changes, deletes, and no changes
- June 9 - Second test remittance file from APO to SHPS
- SHPS would like a third round preliminary production file to be used for eligibility verification purposes. June 24 with a response file by June 26.

NOTE: SHPS will develop a detailed testing plan to be implemented with individual payroll offices.

SHPS will be contacting each APO directly to discuss what, if any, file changes may be necessary. If you do not hear from someone by April 3, please call Cindy King at (502)267-3169.

We want to thank all agency officials for their hard work and continued cooperation in getting this important new benefit off the ground. We will continue to consult with you and keep you informed of developments as we move closer to making payroll allotments a reality for FSA elections. If you have any questions regarding this information, you may contact the SHPS payroll allotment implementation team by sending an email to OPMTech@SHPS.net.

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