Chapter 6 - Flexible Spending Accounts

A ***flexible spending account*** (FSA) is a vehicle that allows an employee to set aside a portion of earnings to pay for qualified expenses most commonly for medical and dependent care. When a new year begins (usually January) the employee determines an amount to be withdrawn from each paycheck pre-tax, from federal and state government to deposit into the plan. The money is deposited into a special account and the employee gets reimbursed when a medical expense is incurred. In previous years, the employee would provide a copy of the receipt and a check for reimbursement would be issued however, increasingly FSAs have been providing employees with a debit card to access the FSA directly to pay for items. For example, when someone is at the doctor and has a copay the card can be used to pay for the service on the spot. FSA's are used:

-To project items not fully covered by health insurance or when there is no coverage

-To project elective medical expenses not covered by health coverage such as cosmetic procedures

The following is general list items that are eligible for FSA reimbursement:
- Prescription medicines, contact lenses and eyeglasses
- Deductibles and co-payments on covered expenses and non-elective cosmetic surgery
- Braces, vasectomies, hysterectomies and birth control
- Fees for hospital services, qualified long-term care services, accident and health
- Long-term care insurance premiums, nursing services, laboratory fees
- Treatments with alcohol, nicotine, drug addiction and acupuncture
- False teeth, hearing aids, crutches, wheelchairs, and guide dogs for the blind or deaf

6.1 Planning for the Year's Expenses
An FSA's coverage period ends either at the time the "plan year" ends for one's plan or at the time when one's coverage under that plan ends.

-Typically a plan year is for one year from January to December

-If an employee leaves the company before the plan year ends, the FSA plan ends on upon termination

The sole point of participating in this plan is that it reduces the taxable income leaving more money in the paycheck. The reason this works is that the money coming out of the check to pay for medical expense would otherwise be paid after tax. One caveat exists in that unused money inputted into the FSA will be forfeited if it is not spent within each plan year (sometimes referred to as the "use it or lose it" rule). Therefore, it is important to create a table. Taking the established budget, the line item for Doctor Appointments is $30 per month would be not be covered by insurance and would be eligible for an FSA. More than likely there will other items that could benefit from an FSA and based on the budget would come out of other areas such as Spending Money or Miscellaneous items.

Item	Frequency	Amount	Yearly Cost
Office Copays	12	$30	$360
Deductibles	1	$200	$200
Prescriptions	12	$13	$158

In Figure above shows that the total projected cost comes to $718 for the year or $59.83 a month:

$720 / 12 month = $59.83 month ($60 rounded)

$720 / 26 paychecks = $27.69 ($28 rounded)

This now changes the line item from $30 to $60.

Bill Name	Amount
Health Care	$60

6.2 The Pretax Advantage

FSA contributions are not based on a percentage deduction like a 401k rather the amount withdrawn is a fixed amount each paycheck. With a $60 per month projection this amount can be offset. Taking the income and taxes from Chapter 2, the FSA will increase the take home pay based on the biweekly schedule.

Chapter 2's calculation:

-First, the gross pay is multiplied by 3% → $3,077 x 3% = $92
-Second, the $92 (401(k)) is subtracted from the $3,077 → $3,077 - $92 = $2,985
-Third, the $2,985 is multiplied by the 25% tax rate → $2,985 x .25 = $746
*-Fourth, the $746 is subtracted from $2,985 → $2,985 - $746 = **$2,239***

FSA calculation:

-First, the gross pay is multiplied by 3% → $3,077 x 3% = $92
-Second, the $92(401(k)) is subtracted from the $3,077 → $3,077 - $92 = $2,985
-Third, the gross pay is subtracted by $28 (FSA) → $2,985 - $28 = $2,957
-Fourth, the $2,957 is multiplied by the 25% tax rate → $2,957 x .25 = $739
*-Fifth, the $739 is subtracted from $2,958 → $2,958 - $739 = **$2,218***

The difference in the paycheck is $21 less in take home pay ($2,239 - $2,218) comes to $546 for the year and an average of $45.50 ($46 rounded) monthly.

26 paychecks x $21 = $546 → 546 / 12 = $45.5 ($46 rounded)

Being that the take home pay is lower by $42 in 10 of the 12 budget months (in 2 of the 12 months it will be $63), the advantage is the $56 deposited in the FSA. (In two of the 12 months it will be $84) This puts additional money back into the budget due to the lower cost basis for the medical expenses. In effect $546 covers $720 in payments saving $174 for the year; reduced: roughly every $.33 covers $.40 in payments or a *17% discount*.

The Budget in 10 of the 12 budget months:

There will be a $14 gain in the budget however, there will be a $4 gap between the $60 in costs and the $56 deposited in the FSA. In effect, the disposable cash is reduced from $14 to $10 when the bill is paid.

Prior Scenario			
Bill Name	**Project**	**Income / Expenses**	
Health Care (Jan)	$30	To Deposit	$4,478
		Remain	$4,478
		Gain/Loss	$0
New Scenario with FSA			
Bill Name	**Project**	**Income / Expenses**	
Health Care (Jan)	$60	Sub Total	$4,436
		In FSA	$56
		New Deposit Total	$4,492
		Remain	$4,478
		Gain/Loss	**$14**

The Budget in 2 of the 12 budget months:

There will be $42 gain in the budget and an additional gain of $28 in the FSA.

Scenario with FSA in a bonus check month			
Bill Name	**Project**	**Income / Expenses**	
Health Care (June)	$60	Sub Total	$6,654
		In FSA	$84
		New Deposit Total	$6,738
		Bonus to Supplemental	$2,218
		New Deposit Total	4,520
		Remain	$4,478
		Gain/Loss	**$42**

With the scenario occurring twice is erases the $4 gap in 10 of the 12 budget months.

10 months: $56 in FSA, $60 budgeted = -$4 → $10 x $-4 = (- $40)

2 months: $168 in FSA, $120 budgeted = $48 → $48 - $40 = $8 gain throughout a year's budget cycle

Being that $4 is made up from disposable cash in 10 months, in the two bonus check months the disposable cash will remain at $42 as there will be a surplus.

Month	Cost	In FSA	From Budget	New FSA Balance
Jan	$60	$56	$4	$0
Feb	$60	$56	$4	$0
Mar	$60	$56	$4	$0
Apr	$60	$84	$0	$24
May	$60	$80	$0	$20
Jun	$60	$76	$0	$16
Jul	$60	$72	$0	$12
Aug	$60	$68	$0	$8
Sep	$60	$64	$0	$4
Oct	$60	$88	$0	$28
Nov	$60	$84	$0	$24
Dec	$60	$80	$0	$20
Totals	**$720**	**$728**	**$12**	**$20**

ALWAYS CHECK THE MATH:
**The $8 (gain) from the Cost and in FSA columns occurs due rounding up on paychecks and projected bills however, using this method will not put any actual total in the negative as long as projected bills are not rounded down. In addition, due to not having a surplus until April the $12 in cash paid out to make up the difference is made up later in the year due to the bonus paychecks. By doing this, the actual bills come in a few dollars above the projection creating the $20 surplus through a one-year budget cycle.*

6.3 Spending the Money before the FSA is Funded
FSAs allow money to withdrawn to pay for expenses before it is fully funded as long as the total amount does not exceed the plan year limit. Taking the budgeted projected health care costs for the year at $720, suppose after the first three months of the plan year Jasper has $180 in the FSA account, then a slip and fall occurs requiring stitches resulting in an out-of-pocket cost of $200. Jasper is short $20 however, the entire $200 will be funded because federal guidelines allow this as long as it does not surpass the total amount that was pledged for at the beginning of the plan year.

6.4 Planning and Unforeseen Funds
As previously mentioned, the drawback to FSAs is that all of the money set aside each year has to be used or it will be forfeited. (Some businesses follow a fiscal year) This is why it is extremely important to plan as accurate as possible as per the medical expenses. For some it is better to come in under budget because all of the money put aside will be used. Coming in over budget means more medical services were required which no one wants. Overall, the real advantage of having additional funds to use is that it allows for people to take care of other needs such as stocking up on contact lenses, cosmetic procedures or elective surgery.

This highlights the importance of a backup plan to use in the event there are unanticipated funds available. Suppose, it is October, two months before the plan year ends and based on money in the FSA along with the additional $120 the total estimated amount comes to $200. It turns out that Jasper has some medical needs to attend to:

-He can elect to stock up on contact lenses
-He has mole that he’d like to remove
-He needs to a stress test to check the condition of his heart
-He needs to get foot surgery to remove bone spurs

From here another table is required to determine costs and the best decision to use his money.

Item	Cost
Contacts	$72
Stress Test	$82
Mole Removal	$122
Foot Surgery	$400

Being that all of the items are elective and the consideration that Jasper will pay all of the items at some point the decision as to where to put the money is based on the individual needs. However, from a logical perspective the goal is to have as much money used up so it isn’t given away. The best choice is to elect for the mole removal and the stress test as it totals $204 which is only $4 over the remaining funds in the FSA projection at year end. There is no reason to get contacts as purchasing them only creates an additional inventory when the normal supply is covering the demand. As for the surgery, being that it costs $400 it would leave $200 without coverage.

The plan into the next year would be to increase the FSA coverage by $400 which equates to an additional $33.3 per month. In addition, if the surgery is elected at the beginning of the year it would not be an issue as that amount would not surpass the total amount that was pledged for at the beginning of the plan year.