

Update Bulletin

FSA Update

January 22, 2007

FSA continues to invent itself in real time. Now that shoppers have started to suffer their first automatic FSA turn-downs, interest is heating up (and the grocers are getting pretty hot too). Here is the latest news on the new FSA industry, including SIGIS, how to meet the IRS 5-year FSA archive requirement, an update on FSA payments processors and the IRS notice that prohibits the use of pharmacy-coded stand-beside payment terminals in grocery stores.

INSTANT SIGIS

Formed only last month, the “Special Interest Group for IIAS Standards” (SIGIS) membership – including MTXEPS – were surprised to learn that their group has received almost immediate recognition and backing from the IRS, and has been set up as the sole “certification” agency for FSA payment operations.

- The previous industry “working group” (known as the IIAS Standards Interest Group) that put together the IIAS spec was morphed into SIGIS, apparently by a for-profit company named “Global Inventures” which saw the opportunity.
- Whereas participation in the past group was free, retailers are now required to pay \$250 to join.
- According to SIGIS, merchants are no longer allowed to perform FSA transactions unless they are SIGIS members.
- SIGIS also requires all SIGIS members intending to do FSA transactions to be “certified.” It is not at all clear yet what this means – SIGIS does not appear to have any personnel who could examine store or POS operations, and some retailers who are SIGIS members are already running FSA without having received any certifications from SIGIS. There are also merchants today that are undoubtedly running FSA transactions without being SIGIS members. We have been told of at least one retailer that simply filled out a form and was declared as “certified.” If there is any certification cost above and beyond the \$250 SIGIS membership fee, we don’t know what that cost might be.
- SIGIS has apparently now received backing from the IRS, which has apparently agreed that any merchant running FSA with and IIAS must have a SIGIS certification, and also that merchants must join SIGIS as a prerequisite to receiving a SIGIS FSA certification.
- There is also talk of SIGIS providing lists of health-care qualified UPCs to SIGIS members. Exactly how, when and in what format this list will be made available is not currently known.

The full capability and eventual direction of SIGIS is obviously unclear, including what kind of PCI-like certifications, audits or product development standards may evolve. All we can recommend at this point is to stay tuned and make sure your customers understand what’s going on to the best of your ability. And if you feel a little confused? Don’t worry, you have plenty of company.

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FSA 5-YEAR ARCHIVE REQUIREMENT

IRS FSA mandates also require stores to archive each health-care debit transaction for five years. Full ticket detail on each item must be available to enable audits – even in the distant future – to demonstrate conclusively that all health-care payment transactions were executed properly and against health-care qualified items only.

Few grocers have the means to separate out these health-care transactions, organize them into searchable databases across multiple stores and build the tools to isolate transaction subsets and report on them, plus manage secure archival off-site storage in compliance with payments industry and federal regulations – especially for five years. Periodically copying T-Logs onto portable hard drives isn't going to cut it either.

To meet this requirement, StoreNext will be providing a fully automated “Connected FSA Archive” service including:

- Data Collection – Transaction information will be automatically collected daily from each store: no manual exports, processes, conversions, consolidations, deletions or transports.
- Database Storage – the customer's enterprise data is maintained worry-free in ultra-secure data centers. And it's always immediately available.
- Transaction Reporting – the full range of FSA transaction reports, based on the selected time period, stores, transaction amounts - even by terminal or cashier - is available.
- FSA Item Reporting – based on the store's criteria, they report which health-care qualified items were sold, the quantities and the health-care qualification itemizers and flags that are critical to federal compliance.
- Drill-Down – simply click any transaction in the report to display the full ticket image and line-by-line transaction details. And the current selection criteria can always be checked with a single click.
- Exporting – FSA Archive facilities include exporting selected data to Excel. Exports can even include the receipt images.
- Archive Management – data is automatically managed: there's no need to manually add transactions or remember to delete old data to meet IRS sunset requirements.
- Plug-and-Play – compatibility currently extends to all FSA-equipped StoreNext ISS45 and ScanMaster POS systems as well as Retailix StoreLine.

The Connected FSA Archive service will be formally announced before the end of January and will be available for immediate installation on all StoreNext systems with FSA capability. The FSA Archive will be a Connected Services feature - since it requires line-item PLU T-Log data to which payments systems have no access.

FSA TRANSACTION PROCESSORS

As we've described in the past, there are several links that need to be in place to process FSA transactions.

1. First, you need to tag the *FSA items* in the PLU file. Most merchants - even without a formal UPC list we hope will come from SIGIS - can do this from information posted on many current Web sites.
2. A POS system with the Inventory Information Approval System (*IIAS*) is required, such as the current up-level ScanMaster 2.5.0, ISS45 8.1.2.1 and ISS45 7.1.2.1 releases which can support the FSA option. (Currently available to dealers.)



3. WinEPS 8.2.3 SP2 is required. This release is the first and only current WinEPS version that takes the FSA totals data from ISS45 or ScanMaster and provides the proper format to the payment processor. (This release is currently available to dealers.) No other payment systems from any other vendor will support ISS45 or ScanMaster POS for FSA transactions.
4. The merchant's *processor* must support FSA transactions. While First Data was quick to the mark and ready January 1, RBSLynk, Shazam, 5th/3rd, Nova and almost all other processors were not able (and in some cases, sadly unaware) to turn their operations around on an IRS dime and be ready in time. Of particular interest to StoreNext dealers with WinEPS or Connected Payments are the following processors:
 - *First Data Atlanta* – FSA Currently available
 - *First Data Concord* – no FSA support currently or planned
 - *Chase Paymentech* – the Paymentech spec was completed and delivered to MTXEPS just this month. Support will be in Connected Payments 2.6 (late February) and MTXEPS 824 (February/March).
 - *5th/3rd* – these requirements were also delivered within the past three weeks. Support will be in Connected Payments 2.6 (late February) and MTXEPS 824 (late February/early March).
 - *RBSLynk* – in WinEPS 824. The RBSLynk interface is not yet scheduled in Connected Payments, although discussions continue with the company.
 - *Shazam* – Shazam's specification for FSA is not yet available.
 - *Nova* – Nova's specification for FSA is not yet available.
5. The Payments Network or *Card Association* must support FSA. This is normally a concern for the processors only, but for the record, only Visa currently processes FSA transactions. MasterCard, Discover and American Express do not provide this capability yet. It has been rumored that Visa has agreed to process transactions for MasterCard, however, taking some of the heat off.

Q&A:

Do all of those links in the financial chain need to be in place for the merchant to run FSA transactions? – Yes.

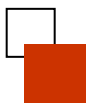
Does StoreNext have any plans to support FSA by creating FSA interfaces to any other payments applications other than MTXEPS? – No.

IRS NOTICE REGARDING STAND-BESIDE TERMINALS

Since the networks no longer accept FSA transactions from grocery stores that haven't updated their software with IIAS, some grocers have considered encoding a stand-beside terminal as if it were in a pharmacy and running FSA transactions from there. This is also being pushed by some payments industry salespeople trying to get extra terminal and line commissions.

Unfortunately, it is strictly illegal, besides guaranteeing a shopper service nightmare.

After the January 9, 2008 StoreNext Wednesday Letter describing the problems, several dealers asked us to provide the specific IRS ruling that prohibits this activity. This statement from IRS



Notice 2007-2, relating to Rev. Rul. 2003-43, 2003-1 C.B. 935 regarding use of electronic media for employer-provided medical expense reimbursements:

After December 31, 2007, health FSA or HRA debit cards may not be used at any store, vendor or merchant that does not have health care related merchant category codes unless the store, vendor or merchant has implemented an inventory information approval system as described in Notice 2006-69.

Since health-care is never a supermarket's primary business, they cannot legally use a health-care related merchant category code (MCC) in any of their payments terminals. Period, end-of-story.

If the words "federal," "illegal," and "IRS" all in the same sentence isn't quite enough for your more stubborn customers, see the [January 9 Wednesday Letter](#), available on the StoreNext Dealer Support Web site for the rest of the problems this would cause.

If you STILL cannot convince a customer to stay away from this kind of scheme, you need to protect yourself: if the store gets ratted out by a competitor, you are likely to be named in a lawsuit, and that's best-case. At worst, you'd end up in federal court for conspiracy in recommending or assisting the grocer to evade federal law.

So any dealer having a customer doing this is strongly recommended to draft (or have your attorney draft) a letter for the grocer's signature that says you had no part in implementing it and that you recommended against it.

To Your Success,



Anthony van Seventer

