

An hourglass-shaped graphic with a globe in the top bulb and another globe in the bottom bulb. The hourglass is light blue and has a dark blue cap at the top. The globe in the top bulb is dark blue, while the globe in the bottom bulb is light blue. The text is centered within the hourglass.

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*Federal Student Aid Need Analysis System: Background,
Description, and Legislative Action*

Charmaine Mercer, Domestic Social Policy Division

January 31, 2008

Abstract. This report provides an overview of the federal need analysis system, including a discussion of recent legislative changes and proposals.

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CRS Report for Congress

Federal Student Aid Need Analysis System: Background, Description, and Legislative Action

Updated January 31, 2008

Charmaine Mercer
Analyst in Social Legislation
Domestic Social Policy Division

<http://wikileaks.org/wiki/CRS-RL33266>



Prepared for Members and
Committees of Congress

Federal Student Aid Need Analysis System: Background, Description, and Legislative Action

Summary

A federal need analysis system underlies the annual allocation of billions of dollars (more than \$80 billion in FY2007) in student financial aid supported by Title IV of the Higher Education Act (HEA) (P.L. 89-329, as amended). The system has regularly been characterized by many as too complex, creating a barrier for students seeking financial assistance, especially low-income students. In the 1992 Higher Education Act (HEA) amendments (P.L. 102-325), Congress overhauled the federal need analysis system to create a “simplified” system consisting of a free, common application form and a single methodology for determining the expected family contribution (EFC) for students desiring to attend postsecondary school. The new system was intended to simplify the process for applying not only for federal student aid, but also for state and institutional aid. More than 14 years later, simplification of need analysis remains a perennial issue. Many researchers and policymakers continue to debate the complexity of the federal need analysis system. They remain concerned with ensuring that the system is able to accurately gauge an individual’s ability to contribute to the cost of a college education.

This report provides an overview of the federal need analysis system, including a discussion of recent legislative changes and proposals. This report will be updated as warranted by significant legislation.

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Federal Student Aid Need Analysis System: Background, Description, and Legislative Action

A federal need analysis system underlies the annual allocation of billions of dollars (an estimated \$80 billion in FY2007) in student financial aid supported by Title IV of the Higher Education Act (HEA) (P.L. 89-329, as amended). The system has regularly been characterized by many as too complex, creating a barrier for students seeking financial assistance, especially low-income students. In the 1992 Higher Education Act (HEA) amendments (P.L. 102-325), Congress overhauled the federal need analysis system to create a “simplified” system consisting of a free, common application form and a single methodology for determining the expected family contribution (EFC) for students desiring to attend postsecondary school. The new system was intended to simplify the process for applying not only for federal student aid, but also for state and institutional aid. More than 14 years later, simplification of need analysis remains a perennial issue. Many researchers and policymakers continue to debate the complexity of the federal need analysis system. They remain concerned with ensuring that the system is able to accurately gauge an individual’s ability to contribute to the cost of a college education.

This report provides an overview of the federal need analysis system, including a discussion of recent legislative changes and proposals. This report will be updated as warranted by significant legislation.

Federal Need Analysis

Federal need analysis (Title IV, Part F) is a complex system that is used to allocate billions of dollars of federal student aid under Title IV of the HEA. It entails gathering financial data, which are provided by the student via the free application for federal student aid (FAFSA);¹ calculating the EFC; and packaging of the applicant’s financial aid award by the postsecondary institution’s financial aid administrator (FAA). This section provides a description of the EFC and how it is calculated. In addition, the role of the FAFSA and student financial aid packaging is examined.

¹ The FAFSA can be submitted through the Internet using FAFSA at [<http://www.fafsa.ed.gov>], electronically through a higher education institution, or with a standard paper application.

Expected Family Contribution

The EFC is the amount that the federal need analysis system determines a family has available to contribute toward postsecondary education expenses. In calculating the EFC, consideration is given to available income (a combination of taxable and untaxed income and benefits), and for some families, available assets. In addition, living expenses, retirement needs, and federal and state tax liability are considered. The income contribution is calculated by determining the total income of a student and his or her family (where applicable), and determining available income by subtracting a series of allowances from total income; a percentage of that available income is considered as an income contribution toward postsecondary education costs. A contribution from assets is similarly calculated. The combination of the available income contribution and asset contribution divided by the number of individuals in the family enrolled in college constitutes the EFC. The EFC process looks back a year for its income data and federal income tax liability. That is, for award year 2007-2008,² 2006 income and federal income tax data will be used.

The calculation of the EFC varies depending upon the applicant's dependency status. There are three separate dependency classifications for individual applicants: dependent student, independent student with dependents, and independent student without dependents.³ These distinctions are important because parental financial information is *not* considered if the applicant meets the statutory definition of an *independent student*. To be classified as statutorily independent [Title IV, Section 480(d)], an applicant must meet **one** of the following conditions:

- 24 years of age or older by December 31st of the award year;
- married;
- enrolled in a graduate or professional program;
- have a dependent other than a spouse;
- orphan or ward of the court (or the applicant was until age 18); or
- a military veteran⁴ or active duty service member.

Applicants who do not meet any of the aforementioned conditions are considered to be dependent for the purposes of Title IV student aid.

² The 2007-2008 award year began July 1, 2007, and ends on June 30, 2008.

³ The calculation of the EFC is delineated in the HEA in Sections 475, 476, and 477. Each of these sections applies to recipients based on their dependency status.

⁴ Section 480(c) defines a veteran as an individual who was engaged in active duty in the U.S. Army, Navy, Air Force, Marines or Coast Guard; and was released under a condition other than dishonorable.

Calculating the EFC. The following is a step-by-step description of the basic calculations used to determine a student's EFC. This description applies to the 2007-2008 award year.⁵ The calculation descriptions are organized as follows: Parents of dependent students (dependent students are included within the calculation for parents) and independent students with dependents other than a spouse; and independent students without dependents other than a spouse. The calculation for parents of dependent students and independent students with dependents other than a spouse are discussed together because the two are identical, except that the dependent student's contribution is added together with the parents'.

EFC Calculation for Parents of Dependent Students and Independent Students with Dependents Other than a Spouse

First Step. Calculate Total Income (TI). TI is calculated by adding the following: adjusted gross income (AGI), income earned from employment, untaxed income and benefits (e.g., welfare and child support payments), other sources of income such as federal education income tax credits (e.g. Hope and Lifetime credits), and certain student grant and scholarship aid (e.g., AmeriCorps benefits).

Second Step. Calculate Allowances. Various allowances for non-educational expenses are subtracted from TI. These allowances are for expenses such as basic living expenses (the income protection allowance), federal income tax liability, state and other taxes, Social Security and employment expenses.

Third Step. Calculate Available Income (AI). AI is calculated by subtracting the various allowances previously described from TI. AI can be a negative number.

Fourth Step. Calculate Asset Contribution (AC). AC is calculated by adding cash, savings, and checking and the net worth of investments, businesses, and farms (excluding the value of the family home, family farm or small family business⁶), and then subtracting an asset protection allowance to determine a "discretionary net worth." The amount of the asset protection allowance increases with the age of the older parent (for dependent students) or the age of the student (for independent students with dependents). The asset protection allowance protects assets that are needed for retirement and future education costs. The AC is equal to 12% of the discretionary net worth. If the result is negative, the AC is zero.

⁵ For a more detailed description of the federal need analysis system, see the *2007-2008 EFC Formula Worksheets and Tables*, available at [<http://www.ifap.ed.gov/efcinformation/attachments/0708EFCFormulaGuideDecFinal.pdf>].

⁶ Section 480(f)(2)(C) defines *family ownership of small business* as: a small business with not more than 100 full-time or full-time equivalent employees that is owned and controlled by the family.

Fifth Step. Calculate Adjusted Available Income (AAI). AC is added to AI to produce the AAI. A progressive assessment schedule is applied to the AAI to determine the proportion of income and assets to be contributed.⁷ The assessment rate ranges from 22% to 47%. Both AAI and the contribution from AAI can be a negative number.

Sixth Step. The contribution from AAI is divided by the number of family members in the household, excluding the parents in the case of dependent students who are enrolled in college. For parents of dependent students, the resulting number is the parent's contribution to the EFC; for independent students with dependents other than a spouse, this number is the EFC.

Next, the *dependent student's* portion of the EFC is calculated as follows:

Seventh Step. Similar to Step 1, TI is calculated for the dependent student based on the amount of untaxed income and benefits, other sources of income, and certain student grant and scholarship aid.

Eighth Step. Dependent students also receive various allowances for federal income tax liability, state and other taxes, and Social Security. However, dependent students do not receive an allowance for employment expenses. In addition, if the parents' AAI is negative (see Fifth Step above), then the amount is converted to a positive amount and added to the total allowances that the student receives.

Ninth Step. Calculate the Available Income (AI). AI is calculated by subtracting the allowances (previously discussed) from TI. AI is then assessed at 50% — this equals the dependent student's contribution from AI. If the result is negative, the AI is zero.

Tenth Step. The calculation for the dependent student asset contribution is the same as the calculation for parents and independent students with dependents (see Third Step above). However, dependent students' assets are assessed at 20%.

Eleventh Step. The final step, the total EFC for the dependent student, is calculated by adding the parents' contribution (see Sixth Step above) to the student's asset and income contribution.

EFC Calculation for Independent Students Without Dependents Other Than a Spouse

The EFC calculation for *independent students without dependents other than a spouse* is a hybrid of the calculation for parents and the one for dependent students. The calculation for this group is as follows:

First Step. Calculate Total Income (TI). TI is calculated by adding the following: income earned from employment; untaxed income and benefits; and other

⁷ Under a progressive formula, as the aggregate amount of income and assets rises, the proportion expected to be contributed toward educational expenses also rises.

sources of income, such as federal education income tax credits and certain student grant and scholarship aid.

Second Step. Subtract Allowances. Various allowances for non-educational expenses are subtracted from TI. These allowances are for expenses such as basic living expenses (the income protection allowances), federal income tax liability, state and other taxes, Social Security, and in some instances, employment expenses.⁸

Third Step. The total allowances are subtracted from TI to produce the available income (AI). Similar to the assessment imposed upon dependent students, the AI of independent students without dependents is also assessed at 50%. The resulting amount is the contribution from AI.

Fourth Step. The asset contribution is calculated by adding together cash, savings, checking, and the net worth of investments, businesses, and farms (excluding the value of the family home, family farm or a small family business). Similar to the protection afforded to parents and independent students with dependents, independent students without dependents also receive an allowance to protect assets that are needed for retirement and future education costs, and the amount of the protection also increases with the student's age. The asset assessment rate for independent students without dependents is 20%.

Fifth Step. The EFC is calculated by adding the contribution from AI to the contribution from AC, and then dividing by the number of family members in college.

Special EFC Conditions. In addition to creating a common application form and a single methodology for determining need, Congress has also sought to further reduce the application burden for those applicants with family incomes at or below a specified threshold. Under the *simplified needs test* (SNT),⁹ the EFC calculation does not consider assets for the student (or spouse if married) or parent (if the student is a dependent) if their adjusted gross income (AGI) is less than \$50,000, and certain conditions regarding federal tax returns are met.¹⁰ The *automatic zero EFC* (hereinafter auto-zero EFC)¹¹ sets the expected family contribution to zero for a dependent student's parents and the dependent student, or for an independent student

⁸ Independent students without dependents other than a spouse receive an employment expense allowance only if they are married and both the student and the spouse are employed.

⁹ HEA, Section 479(b).

¹⁰ To be eligible for SNT, the student and his or her parents must not have to file an income tax return, or must file or be eligible to file federal tax form 1040A or 1040EZ. Individuals who complete federal tax form 1040 solely to claim the Hope or Lifetime Learning tax credit are eligible as well. Further, eligibility for SNT can be satisfied if any family member, including the applicant, has received a federal means-tested benefit.

¹¹ The same income tax filing requirements and receipt of a federal means-tested benefit that apply to SNT applicants apply to auto-zero applicants as well. Auto-zero EFC is not provided to independent students without dependents.

who has dependents and has an AGI not greater than \$20,000. The auto-zero EFC is **not** provided to independent students without dependents other than a spouse.

FAFSA

The FAFSA is used to collect most of the information that is utilized to calculate the EFC. Applicants are required to report identifying information such as their name and Social Security number, information about the institutions where their information should be forwarded, and financial information pertaining to income and assets. As mentioned above, there are three ways to complete the FAFSA — via the web, electronically through a higher education institution, or by filling out a paper form.

The paper, web, and on-site electronic versions of the FAFSA differ in the ways that submitted data are treated. As a result, the two electronic versions of the FAFSA provide advantages that the paper form does not. For example, the paper version lacks internal and end-of-entry data edits that require the applicant to resolve conflicts and complete all necessary fields prior to submission. In addition, the two electronic versions contain “skip logic,” which enables applicants, if they choose, to skip over the sections of the FAFSA that do not pertain to them. As a result, eligible applicants who apply via the electronic formats are able to take advantage of either the SNT or auto-zero EFC because the technology allows sections to be skipped where applicable. At present, there is no comparable approach available for paper form filers.

EFC and Packaging

FAFSA data are submitted to a Central Processor (an entity working under contract for the U.S. Department of Education) that calculates the aid applicant’s EFC based on statutorily defined rules. From the Central Processor, the EFC and other summary data are reported to FAAs and to the FAFSA filer. The FAA determines the student’s need for federal student aid and other sources of aid, based primarily upon the EFC and cost of attendance (COA).¹² This is true for all federal student aid programs (e.g., loans, campus-based programs) except for the Pell Grant program.¹³ For nearly all Pell recipients, the award is calculated by subtracting the EFC from the maximum appropriated Pell Grant for the year (i.e., without regard to the COA). The FAA determines need in conjunction with each program’s award rules and puts together the financial aid award or package, which consists of the specific sources and amounts of student aid each applicant will receive to help pay for his or her education-related expenses.

¹² The cost of attendance (COA) is a measure of student’s educational expenses. It is statutorily defined in Title IV, Section 472 of the HEA. In general, it is the sum of tuition and fees; an allowance for books, supplies, transportation, and miscellaneous personal expenses; and a room and board allowance.

¹³ For additional information regarding the Pell grant program, see CRS Report RL31668, *Federal Pell Grant Program of the Higher Education Act: Background and Reauthorization*, by Charmaine Mercer.

The financial aid package starts with the Pell Grant, the federal foundation for student aid. Other aid, such as campus-based student aid program funds, state and institutional aid, and federal loans, are added to create the student's aid package. The aid applicant is then notified concerning the composition of the financial aid package. Some of these calculations vary from FAA to FAA. Not only does the aid administrator have some discretion in the awarding of campus-based student aid, but Section 479A of the HEA explicitly gives FAAs discretion to adjust, on a case by case basis, the COA or the values of the items used to calculate the EFC to "allow for treatment of an individual eligible applicant with special circumstances." The statute offers examples of these special circumstances (such as the recent unemployment of a family member) when the FAA might exercise this professional judgement if he or she chooses to do so.

Legislative Proposals Addressing Federal Need Analysis

As discussed, simplification of need analysis is a perennial issue. Several proposals have been introduced that attempt to further simplify the process. This section reviews major legislation of the 110th Congress that addresses need analysis.

Although the College Cost Reduction and Access Act (CCRAA) made significant changes to the federal need analysis formula, both S. 1642 and H.R. 4137 (Senate and House HEA reauthorization bills) include provisions to further amend select aspects of need analysis formula. Specifically, both bills propose to modify the definition of room and board to include a room and board allowance for students who live in housing located on a military base or who receive a basic allowance for housing. In addition, both bills would exclude the value of military housing or a military housing allowance received by a student or his or her parent from consideration as untaxed income or benefits in the need analysis formula.