Simplifying the EFC Formula

Testimony by Mark Kantrowitz, Publisher of FinAid.org
Advisory Committee on Student Financial Assistance
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Thank you for allowing me to comment on the simplification of the EFC formula.

The primary purpose of student financial aid is to enable students with financial need to obtain a college education. It is not just about money; money is merely a means to an end. Unfortunately, the complexity of student aid acts as a barrier to access. Too much emphasis has been placed on achieving a "perfect" assessment, leading to need analysis formulas and application forms that grow more complicated every year. We've been chasing after a false sense of precision.

About a quarter of low income students do not currently complete the Free Application for Federal Student Aid (FAFSA), and low income students obtain bachelor's degrees at about one-sixth the rate of upper income students. This is a national tragedy. Families are intimidated by the complexity and invasiveness of the FAFSA and Expected Family Contribution (EFC), and many incorrectly believe that they are ineligible for student aid because of the lack of predictability and transparency in the need analysis process.

While my remarks today are focused on the EFC formula (the Federal Need Analysis Methodology), most other aspects of the student aid system also need to be streamlined and simplified.

A perfect assessment of ability to pay is not possible. The intent of the federal need analysis system is to evaluate ability to pay during the award year. It accomplishes this by using the prior tax year as a proxy for the award year, in part because the prior tax year data is available and verifiable. But this means that the assessments of financial need are already approximations, since family financial circumstances often change significantly during the 9 months from the prior tax year to the award year and throughout the 9-10 months of the award year. Likewise, the EFC formula tables are based in part on a projection of the December-to-December Consumer Price Index (CPI-U). These estimates are often significantly inaccurate. For example, in 2004 the actual inflation rate was more than twice the US Department of Education's official estimate.

Given that the current formula is an approximation, it is worthwhile to sacrifice a little accuracy in favor of a significantly simplified form and formula. Any added inaccuracy will be masked by the inaccuracy already present in the current formula.

I elaborated on this approach in the design of the QuickEFC calculator for the FinAid.org web site. This calculator, which was launched six years ago in September 2000, asks whether all of the more than 100 questions on the FAFSA are really necessary. The basic design involves performing a sensitivity analysis that identifies the potential impact on the EFC of replacing each data element with an average or default value. Other figures, such as the federal income tax, are replaced with calculated estimates. This reduces the number of questions by an order of magnitude (to about a dozen questions), dramatically simplifying the form. For most students the

resulting EFC varies by less than $500 from the actual EFC. This QuickEFC calculator has been used by the Gates Millennium Scholarship Program as part of their scholarship application. A few years ago I introduced the QuickEFC Chart Generator, which generates simple lookup tables based on income, assets and family size.

Similarly, I included one-page worksheets for estimating dependent and independent student EFC figures in the *FastWeb College Gold* book published today by Harper Collins. Copies of these worksheets are included with my written remarks. Compare these worksheets with the 35-page EFC Formula worksheets published annually by the US Department of Education.

Recommendations

I urge the Advisory Committee to evaluate the potential impact of these ideas on EFC scores using actual application data, as is currently proposed. (I'd encourage ACSFA to make the data set available for study by other researchers.) It should be possible to calculate the average, maximum and 90th percentile variance and the percentage of EFC scores changing by more than $500 for all students and all Pell-eligible students nationwide. The impact should also be evaluated according to other segmentations of the student population, such as dependency status, state of residence, college attended, college level and control, income quintile, family size, age, gender and year-in-school. This will help ensure universal adoption of the simplified need analysis process. Otherwise, state agencies and colleges might be tempted to abandon the FAFSA in favor of their own forms, leading to a net increase in complexity.

There are several proposals I feel are worth evaluating:

- Eliminating data elements from the FAFSA that have a minimal impact on the EFC score, as I did in FinAid's QuickEFC calculator.
- Substituting family income and family asset figures for the separate student and parent income and asset figures. The current distinctions are arbitrary, especially for families where the student is the primary wage-earner. (Of course, the assessment ratios would need to be adjusted to fit the data.)
- Eliminating asset figures entirely from the formula, instead substituting average values pegged to family income. Less than 10% of dependent students have any contribution from parent assets, so this change would merely accelerate the current trend. It would also provide a significant incentive for college savings.
- Eliminating Worksheets A and B (except possibly for child support and cash support).
- Changing the base year from the prior tax year to the prior-prior tax year (PPY), allowing for earlier calculation of EFC figures. I believe that PPY is just about as good a proxy for award year income.
- Averaging income over the previous three years. This would smooth out volatility in income from one year to the next.
- Align the formula with more IRS definitions, to permit more data elements to be obtained from the IRS (e.g., substitute the number of exemptions for family size).

Some of the potential benefits of these proposals include:

- Allowing financial aid applications to be submitted at the same time as college admissions applications, instead of the current “not before January 1” requirement.
- Permitting students to evaluate their net and out-of-pocket college costs before applying for admission, instead of after they are admitted.
- Allowing early financial aid estimates to be calculated for high school students during the spring semester of their junior year.
- Simplifying the FAFSA enough that it would fit on a postcard.
- Permitting a real-time data match with the IRS, instead of an after-the-fact data match.
- Allowing FAFSA data to be obtained directly from the IRS, eliminating the need for a separate financial aid application.
- Increasing the predictability and transparency of the need analysis process.
- Replacing annual financial aid applications with a single application for all four years of college.

Thank you for your consideration of these ideas.

EFC ESTIMATION WORKSHEET: DEPENDENT STUDENTS

This worksheet contains a simplification of the Federal Need Analysis Methodology. The Expected Family Contribution (EFC) figures it calculates are estimates and may differ from the actual figures. For your actual EFC, use FinAid's EFC calculator at www.finaid.org/calculators.

PARENT INFORMATION	
A. Age of Older Parent	
B. Number in Family	
C. Number of Children in College	
D. Parent Income	
E. Parent Assets	

STUDENT INFORMATION	
F. Student Income	
G. Student Assets	

Do not count retirement funds, life insurance, and the family's primary residence as assets.

If Parent Income (D) ≤ $20,000 then set EFC to 0 and stop.
If Parent Income (D) < $50,000, then set all asset figures to $0 and continue.

ALLOWANCES AGAINST PARENT INCOME	
Parent FICA (IRS Forms W2, 1099)	
Parent Federal Income Tax (Last line of Tax & Credits in IRS Form 1040)	+
Calculate State Income Tax Allowance as 6% of Line D (above)	+
Calculate Parent Income Protection Allowance as $10,000 + Line B × $3,460 – Line C × $2,460	+
Calculate Employment Expense Allowance as 35% of income in Line D or $3,100, whichever is less	+
1. TOTAL ALLOWANCES	=

AVAILABLE PARENT INCOME	
Total Parent Income (Line D)	
Total Allowances (Line 1)	-
2. AVAILABLE INCOME	=

PARENT CONTRIBUTION FROM ASSETS	
Total Parent Assets (Line E)	
Reduction for Business/Farm Assets (50% of total Business/Farm Assets or $250,000, whichever is less)	-
Asset Protection Allowance $1,732 × (Line A – 23) If unmarried, divided result by 2.3	-
3. Discretionary Net Worth	=
Asset Conversion Rate	X 12%
4. PARENT CONTRIBUTION FROM ASSETS	=

PARENT CONTRIBUTION	
Parent Contribution from Assets (Line 4)	
Available Parent Income (Line 2)	+
Adjusted Available Income (AAI)	=
Contribution from AAI 32% of the AAI amount ≤ $26,000 and 47% of the amount > $26,000	
Divide by the Number of Children in College (Line C)	÷
5. PARENT CONTRIBUTION	=

ALLOWANCES AGAINST STUDENT INCOME	
Student FICA (IRS Forms W2, 1099)	
Student Federal Income Tax (Last line of Tax & Credits IRS Form 1040)	+
Calculate State Income Tax Allowance as 3% of Line F (above)	+
Income Protection Allowance. $2,550 in 2006-07 or $3,000 in 2007-08	+
6. TOTAL ALLOWANCES	=

AVAILABLE STUDENT INCOME	
Total Student Income (Line F)	
Total Allowances (Line 6)	-
7. AVAILABLE INCOME	=

STUDENT CONTRIBUTION FROM ASSETS	
Total Student Assets (Line G)	
Reduction for Business/Farm Assets (50% of total Business/Farm Assets or $250,000, whichever is less)	-
8. Adjusted Net Worth	=
Asset Conversion Rate Multiply by 35% in 2006-07 Multiply by 20% in 2007-08	X
9. STUDENT CONTRIBUTION FROM ASSETS	=

STUDENT CONTRIBUTION FROM INCOME	
Student Available Income (Line 7)	
Income Conversion Rate	X 50%
10. STUDENT CONTRIBUTION FROM INCOME	=

STUDENT CONTRIBUTION	
Student Contribution from Assets (Line 9)	
Student Contribution from Income (Line 10)	+
11. STUDENT CONTRIBUTION	=

EXPECTED FAMILY CONTRIBUTION (EFC)	
Parent Contribution (Line 5)	
Student Contribution (Line 11)	+
12. ESTIMATED EFC	=

EFC ESTIMATION WORKSHEET: INDEPENDENT STUDENTS

This worksheet contains a simplification of the Federal Need Analysis Methodology. The Expected Family Contribution (EFC) figures it calculates are estimates and may differ from the actual figures. For your actual EFC, use FinAid's EFC calculator at www.finaid.org/calculators.

STUDENT INFORMATION	
A. Age of Older Student/Spouse	
B. Number in Family	
C. Number in College	
D. Student & Spouse Income	
E. Student & Spouse Assets	

Do not count retirement funds, life insurance, and the family's primary residence as assets.

If Income (D) ≤ $20,000 then set EFC to 0 and stop.
If Income (D) < $50,000, then set all asset figures to $0 and continue.

ALLOWANCES AGAINST INCOME	
FICA (IRS Forms W2, 1099)	
Federal Income Tax (Last line of Tax & Credits in IRS Form 1040)	+
Calculate State Income Tax Allowance as 3% of Line D (above)	+
Income Protection Allowance *If no dependents other than spouse*: If unmarried/separated or spouse is enrolled ≥ half time, add $5,790 in 2006-07 or $6,050 in 2007-08 If spouse is enrolled < half time add $9,260 in 2006-07 or $9,700 in 2007-08 *If dependents other than spouse*: $10,000 + Line B × $3,460 − Line C × $2,460 in 2006-07 or $10,000 + Line B × $3,670 − Line C × $2,610 in 2007-08	+
Calculate Employment Expense Allowance as 35% of income in Line D or $3,100 (2006-07) or $3,200 (2007-08), whichever is less	+
1. TOTAL ALLOWANCES	=

AVAILABLE INCOME	
Total Income (Line D)	
Total Allowances (Line 1)	-
2. AVAILABLE INCOME	=

CONTRIBUTION FROM INCOME	
Available Income (Line 2)	
Income Conversion Rate *If no dependents other than spouse*: Multiply by 50% *If dependents other than spouse*: No change	X
3. CONTRIBUTION FROM INCOME	=

CONTRIBUTION FROM ASSETS	
Total Student Assets (Line E)	
Reduction for Business/Farm Assets (50% of total Business/Farm Assets or $250,000, whichever is less)	-
4. Adjusted Net Worth	=
Asset Protection Allowance $1,732 × (Line A − 23) If unmarried, divide result by 2.3	-
5. Discretionary Net Worth	=
Asset Conversion Rate *If no dependents other than spouse*: Multiply by 35% in 2006-07 Multiply by 20% in 2007-08 *If dependents other than spouse*: Multiply by 12% in 2006-07 Multiply by 7% in 2007-08	X
6. CONTRIBUTION FROM ASSETS	=

EXPECTED FAMILY CONTRIBUTION (EFC)	
Contribution from Assets (Line 6)	
Contribution from Income (Line 3)	+
Adjusted Available Income (AAI)	=
Contribution from AAI *If no dependents other than spouse*: 100% of the AAI amount *If dependents other than spouse*: 32% of the AAI amount ≤ $26,000 and 47% of the amount > $26,000	
Divide by the Number in College (Line C)	÷
8. ESTIMATED EFC	=