

# Need Analysis and Professional Judgment

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# Overview

- Review of Need Analysis Methodology
- Relationship of Need Analysis to Professional Judgment
- Counterintuitive Consequences of Adjustments



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# Principles of Need Analysis

- Family has primary responsibility to pay
- Estimate ability to pay without regard lifestyle choices or willingness to pay
- Snapshot Philosophy
- Prior tax year as proxy for award year
- Focus on discretionary income and discretionary net worth (free cash flow)
- No double-dipping



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# Income

- Parent discretionary income based on income after subtracting allowances
  - Basic living expenses (IPA) based on HHS & NIC
  - State and Federal taxes
- Student income assumed to be primarily for education
  - Excludes student aid counted in taxable income (Worksheet C)
  - Excludes dependent student IPA of \$2,420



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# Total Income

- Based on prior tax year income
  - Starts with AGI, because it is verifiable
- Adds back in discretionary deductions
  - Worksheet A (untaxed income for lower income families)
  - Worksheet B (other untaxed income and benefits: tax deferred income, child support received, and cash support)
- Subtracts exclusions from taxable income
  - Worksheet C (student aid included in taxable income, child support paid)

*Total Income =*

*AGI + Worksheet A + Worksheet B - Worksheet C*



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# Available Income

- Measure of discretionary income
- Subtracts allowances from total income
  - Income Protection Allowance (IPA)
  - Employment Expense Allowance (EPA)
  - State and Other Tax Allowance
  - Federal Tax Liability
  - FICA Tax Liability



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# Income Protection Allowance (IPA)

- Modest allowance for basic living expenses
  - 30% food
  - 22% housing (including utilities, appliances & furnishings)
  - 9% transportation
  - 16% clothing and personal care
  - 11% medical care
  - 12% other family consumption (includes life and disability insurance, entertainment, periodicals)
- Approximately \$9,470 + \$3,280 HHS - \$2,330 NIC
- Allowance adjusted annually for inflation



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# Employment Expense Allowance

- Expense allowance for double income households
- Intended to address increased costs for childcare, housekeeping, transportation, meals away from home
- \$3,000 or 35% of lower income, whichever is less



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# Assets

- Parent discretionary net worth based on percentage of net worth after excluding certain assets
  - Excludes net worth of family's primary residence
  - Excludes qualified retirement funds
  - Excludes allowance to supplement Social Security (APA)
- Student assets assumed to be primarily for education (no APA)



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# Income & Asset Assessment Percentages

- Student
  - 50% of income above IPA
  - 35% of assets (no APA)
- Parent
  - Bracketed system
  - 22% to 47% of income above allowances
  - Maximum of 5.64% (12% of 47%) of assets above allowances and after exclusions



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# Changes to Data Elements

- Three types of changes
- Corrections
  - Data not correct as of application date
  - May make corrections at any time
- Updates
  - Data was correct, but has since changed
  - Only HHS & NIC during verification if not due to change in applicant's marital status
- Adjustments and Overrides
  - Professional judgment justified by special circumstances



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# Methods of Implementing Adjustments

- Amount of adjustment dictated by financial impact of special circumstance
- Data element often indicated by special circumstance
- If adjustment to income, can reduce AGI or Worksheets A and B or increase Worksheet C
- Use worksheets when no AGI, or to make it easier to match FAFSA AGI with IRS AGI



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# No Double Dipping

- Adjustments limited by degree to which already considered by the formula
- IPA and EEA allowances



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# Medical Expense Example

- Subtract amounts already considered from adjustment
  - 11% of IPA
  - Insurance reimbursements
  - Above-the-line deductions (self-employed health insurance deduction for 70% of health insurance premiums)
  - Below-the-line credits (Health Coverage Tax Credit)
- Family of 4 with 1 in college and \$4,000 in medical expenses
  - IPA of \$21,070 → 11% is \$2,317.70
  - Adjustment of \$4,000 - \$2,318 = \$1,682



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# Schedule A Example

- Itemized deductions on Schedule A affect taxes paid but not AGI
- Therefore acceptable to adjust income to reflect items listed on Schedule A, such as unreimbursed employee expenses (tools of trade, union dues)
- Need to consider EEA as offset to adjustment



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# Double Counting One-Time Events

- One-time events double-counted as income and assets
  - Not reflective of award year income
- Adjustment to eliminate non-recurring event as income, leaving it as asset
  - Inheritance, insurance settlement, worker's comp
- Replace recurring event income with average of past three years
  - Unusual capital gains



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# Counterintuitive Results

- Sometimes an adjustment results in an increase instead of a decrease
- Most often due to error
  - Adjustment made to wrong worksheet
  - Using tax tables instead of actual tax liability (e.g., foreign income exclusion)
- Sometimes due to quirks in formula



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# Number in College (NIC)

- NIC decreases and increases EFC
  - Decreases EFC
    - Parent contribution divided by NIC
  - Increases EFC
    - Reduces IPA by \$2,330 per additional NIC
- EFC increases when increase NIC when  $PC/NIC < 47\% * \$2,330 = \$1,095$
- Only occurs for Pell eligible students (low PC)



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# Married Students, Different EFCs

- Caused by differences in student APA
  - APA based on age of student, not age of older student
- Prerequisites
  - Couple born in different years
  - One student at least 26 years old
  - Assets exceed APA for younger student
- Amount of difference depends on difference in ages and amount of assets
  - Maximum difference of \$4,000 in EFCs
  - Penalty \$80 to \$140 per year difference in ages



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# Worksheet C Matches AGI

- Edit check assumes error when
  - Worksheet C matches student total income
  - Worksheet C  $\geq$  90% parent total income
- Often triggered when student's only income source is Federal Work Study and Americorp
- Sometimes triggered by professional judgment, yielding increase in EFC
  - Fix by using assumption override code 5 for parents, 6 for students



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# Bigger than Expected Change in EFC

- Threshold effect for Automatic Zero EFC at \$15,000 in income
- Threshold effect for Simplified Needs Test at \$50,000 in income
- Dependent other than spouse (e.g., first child) switches independent student to more favorable formula



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# Dependency Override Increases EFC

- Dependency override usually decreases EFC
  - IPA \$3,000 higher for independent students
- If cash support from parents included on Worksheet B, and parent income was sheltered by allowances, may lead to an increase in EFC
- Wiggle room between independent student IPA and parent IPA



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# More Information

- FinAid's Guide to Professional Judgment
  - 100 pages of best practices
  - More than 50 special circumstances
- <http://www.finaid.org/educators/pj/>



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