



## ABCs of Financial Aid

These days, it's hard to talk about college without mentioning financial aid. Yet this pairing isn't a marriage of love, but one of necessity. In many cases, financial aid may be the deciding factor in whether your child attends the college of his or her choice or even attends college at all. That's why it's important to develop a basic understanding of financial aid before your child applies to college. Without such knowledge, you may have trouble understanding the process of aid determination, filling out the proper aid applications, and comparing the financial aid awards that your child receives.

But let's face it. Financial aid information is probably not on anyone's top ten list of bedtime reading material. It can be an intimidating and confusing topic. There are different types, different sources, and different formulas for evaluating your child's eligibility. Here are some of the basics to help you get started.

### What is financial aid?

Financial aid is money distributed primarily by the federal government and colleges in the form of loans, grants, scholarships, or work-study jobs. A student can receive both federal and college aid.

Grants and scholarships are more favorable than loans because they don't have to be repaid--they're free money. In a work-study program, your child works for a certain number of hours per week (either on or off campus) to earn money for college expenses. Obviously, an ideal financial aid package will contain more grants and scholarships than loans.

### Need-based aid vs. merit aid

Financial aid can be further broken down into two categories--need-based aid, which is based on your child's financial need; and merit aid, which is awarded according to your child's academic, athletic, musical, or artistic merit.

The majority of financial aid is need-based aid. However, in recent years, merit aid has been making a comeback as colleges (particularly private colleges) use favorable merit aid packages to lure the best and brightest students to their campuses, regardless of their financial need. However, the availability of merit aid tends to fluctuate from year to year as colleges decide how much of their endowments to spend, as well as which specific academic and extracurricular programs they want to target.

### Sources of merit aid

The best place to look for merit aid is at the colleges that your child is applying to. Does the

college offer any grants or scholarships for academic, athletic, musical, or other abilities? If so, what is the application procedure? College guidebooks can give you an idea of how much merit aid (as a percentage of a general student's overall aid package) each college has provided in past years.

Besides colleges, a wide variety of private and public companies, associations, and foundations offer merit scholarships and grants. Many have specific eligibility criteria. In the past, sifting through the possibilities could be a daunting task. Now, with the Internet, there are websites where your child can input his or her background, abilities, and interests and receive (free of charge) a matching list of potential scholarships. Then it's up to your child to meet the various application deadlines. However, though this avenue is certainly worth exploring, such research (and subsequent work to complete any applications) shouldn't come at the expense of researching and applying for the more common need-based financial aid.

#### Sources of need-based aid

The main provider of need-based financial aid is the federal government, followed by colleges. States come in at a distant third. The amount of federal aid available in any given year depends on the amount that the federal budget appropriates, and this aid is spread over several different financial aid programs. For colleges, need-based aid comes from a college's endowment, and policies may differ from year to year, resulting in an uneven availability of funds. States, like the federal government, must appropriate the money in their budgets.

The federal government's aid application is known as the FAFSA, which stands for Free Application for Federal Student Aid. The federal government and colleges use the FAFSA when federal funds are being distributed (colleges are responsible for administering certain federal financial aid programs). When colleges distribute their own financial aid, they use one of two forms. The majority of colleges use the PROFILE application, created by the College Scholarship Service of Princeton, New Jersey. A minority of colleges use their own institutional applications. The states may use the FAFSA or may require their own application. Contact your state's higher education authority to learn about the state aid programs available and the applications that you'll need to complete.

The FAFSA is filed as soon after January 1 as possible in the year your child will be attending college. You must wait until after January 1 because the FAFSA relies on your tax information from the previous year. The PROFILE (or individual college application) can usually be filed earlier than the FAFSA. The specific deadline is left up to the individual college, and you'll need to keep track of it.

#### How is my child's financial need determined?

The way your child's financial need is determined depends on which aid application you're filling out. The FAFSA uses a formula known as the federal methodology; the PROFILE (or a college's own application) uses a formula known as the institutional methodology. The general process of aid assessment is called needs analysis.

Under the FAFSA, your current income and assets and your child's current income and assets are run through a formula. You are allowed certain deductions and allowances against your income, and you're able to exclude certain assets from consideration. The result is a figure known as the expected family contribution, or EFC. It's the amount of money that you'll be expected to contribute to college costs before you are eligible for aid.

Your EFC remains constant, no matter which college your child applies to. An important point: Your EFC is not the same as your child's financial need. To calculate your child's financial need, subtract your EFC from the cost of attendance at your child's college. Because colleges aren't all the same price, your child's financial need will fluctuate with the cost of a particular college.

For example, you fill out the FAFSA, and your EFC is calculated to be \$5,000. Assuming that the cost of attendance at College A is \$18,000 per year and the cost at College B is \$25,000, your child's financial need is \$13,000 at College A and \$20,000 at College B.

The PROFILE application (or the college's own application) basically works the same way. However, the PROFILE generally takes a more thorough look at your income and assets to determine what you can really afford to pay (for example, the PROFILE looks at your home equity and retirement assets). In this way, colleges attempt to target those students with the greatest financial need.

What factors the most in needs analysis? Your current income is the most important factor, but other criteria play a role, such as your total assets, how many family members are in college at the same time, and how close you are to retirement age.

How does financial need relate to my child's financial aid award?

When your child is accepted at a particular college, the college's financial aid administrator will attempt to create a financial aid package to meet your child's financial need. Sometime in early spring, your child will receive these financial aid award letters that detail the specific amount and type of financial aid that each college is offering.

When comparing awards, first check to see if each college is meeting all of your child's need (colleges aren't obligated to meet all of it). In fact, it's not uncommon for colleges to meet only a portion of a student's need, a phenomenon known as getting "gapped." If this happens to you, you'll have to make up the shortfall, in addition to paying your EFC. College guidebooks can give you an idea of how well individual colleges meet their students' financial need under the entry "average percentage of need met" or something similar. Next, look at the loan component of each award and compare actual out-of-pocket costs. Remember, grants and scholarships don't have to be repaid and so don't count toward out-of-pocket costs. Again, you would like your child's need met with the highest percentage of grants, scholarships, and work-study jobs and the least amount of loans.

If you'd like to lobby a particular school for more aid, tread carefully. A polite letter to the financial aid administrator followed up by a telephone call is appropriate. Your chances for

getting more aid are best if you can document a change in circumstances that affects your ability to pay, such as a recent job loss, unusually high medical bills, or some other unforeseen event. Also, your chances improve if your child has been offered more aid from a direct competitor college, because colleges generally don't like to lose a prospective student to a direct competitor.

How much should our family rely on financial aid?

With all this talk of financial aid, it's easy to assume that it will do most of the heavy lifting when it comes time to pay the college bills. But the reality is you shouldn't rely too heavily on financial aid. Although aid can certainly help cover your child's college costs, student loans make up the largest percentage of the typical aid package, not grants and scholarships. As a general rule of thumb, plan on student loans covering up to 50 percent of college expenses, grants and scholarships covering up to 15 percent, and work-study jobs covering a variable amount. But remember, parents and students who rely mainly on loans to finance college can end up with a considerable debt burden.

The 360 Degrees of Financial Literacy Web site offers general information for managing personal finances and does not recommend specific financial actions. For financial advice tailored to your situation, please contact an expert such as a CPA or a personal financial advisor.

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