

BNA Insights

Supplemental and Variable Compensation Arrangements: Federal Grant Rules and Policies



By ROBERT J. KENNEY JR.

1. Introduction

To those charged with the responsibility of operating an economically viable academic research enterprise, few ideas come more readily to mind than linking researchers' compensation in part to the amount of their external grant support. It is completely understandable that this would be so. Particularly in difficult financial times such as these, when both sponsored and non-sponsored sources of research support are increasingly scarce, it is only natural that research institutions would consider various forms of salary incentives, supplements, and other variable compensation arrangements in looking for ways to assemble competitive salary packages, encourage researchers to apply for external grant support, or temper the economic risk of shortfalls in sponsored funding. In the commercial business world it is common to link compensation with financial performance in this way. In the world of federal research, however, such performance-based compensation arrangements generally are disfavored.

The following statement of one federal official, a respected authority on cost reimbursement issues, reflects the generally negative government view of most such arrangements:

"Research supplements are suspect, and variable components of salary contingent on external support appear plainly unallowable to NIH/Federal awards."¹

¹ AAMC Effort Reporting Conference Call: Questions and Answers, Feb. 10, 2005. This document is a written version of questions and answers addressed by an official of the National

Robert J. Kenney Jr. is a partner with Hogan Lovells US LLP in Washington.

The federal government takes its policy against salary supplementation or augmentation seriously. The 2011 work plan of the Department of Health and Human Services' Office of Inspector General (OIG), for example, announced that one of the DHHS OIG's subjects of scrutiny this fiscal year would be the charging of "extra" faculty compensation to federal sponsored agreements awarded to colleges and universities:

Review of Extra Service Compensation Payments Made By Education Institutions

We will review payments for extra compensation charged to Federally sponsored grants, contracts, and cooperative agreements by education institutions to determine whether the payments were in accordance with Federal regulations. Pursuant to OMB Circular A-21, *Cost Principles for Education Institutions*, Att., § J.8.d(1), charges for work performed on sponsored agreements by faculty members will be based on the individual faculty member's regular compensation. Any charges for work representing "extra compensation" above the faculty member's base salary are allowable provided that arrangements are specifically provided for in the agreement or are approved in writing by the sponsoring agency. We will determine whether extra compensation payments were properly calculated and approved by the sponsoring agency. Recent OIG work has indicated problems with extra compensation payments charged to Federally sponsored agreements at several colleges and universities.

From the perspective of the federal government, what is at stake is the reasonableness of the researcher's salary. The federal policy² against salary augmen-

Institutes of Health and a representative of the Association of American Medical Colleges in a conference call with representatives of research institutions. Although the document does not expressly attribute the answers to the NIH official, it is generally understood that they are consistent with his views.

² This article refers to a federal "policy" against salary augmentation, rather than federal "rules." These two terms often are used interchangeably in the grants administration context, and either could have been used here. "Policy" was chosen because in fact there is only one true "rule" on the subject—Section J.10.d(1) of OMB Circular A-21—and that rule is far from comprehensive. All other sources of federal guidance on the subject appear in policy documents such as the NIH *Grants Policy Statement* or in less formal policy pronouncements by agencies and comments by agency officials. The use of the phrase "federal policy" in the salary augmentation context is shorthand for this collection of formal and informal sources of guidance, and should not be taken to mean that a clear, consistent, and understandable federal policy on the subject can be found anywhere.

tation (i.e., increasing salary to a level above "regular base salary") appears to be based on the rationale that once a researcher's regular base salary has been set in accordance with a grantee's regular compensation policies, that base salary reflects the researcher's presumptively reasonable level of compensation. Almost by definition, therefore, any augmentation of that base salary during the salary year would in the government's view make the researcher's compensation unreasonably high.

There can be no quarrel with the principle that salaries charged to federal projects must be reasonable and consistent with the general compensation policies of a grantee. Moreover, once a reasonable salary level is set for a researcher based on a grantee's compensation policies, it would be hard to justify an *ad hoc* augmentation of that salary based solely on the receipt of additional external salary support in a new federal grant award. It is understandable that the federal rule against salary augmentation should apply in such a case. There are, however, other types of situations in which it does not seem unreasonable for a grantee to consider external salary support—federal or non-federal—in determining the salary levels of researchers. In these situations the federal anti-augmentation principle should not be an impediment to the proposed arrangement, but unfortunately it often is.

The purpose of this article is to examine the federal policy against augmentation of researchers' salaries, with the objective of determining its boundaries and the kinds of arrangements to which it does or does not apply—or should or should not apply. Considerable misunderstanding surrounds the anti-augmentation principle, and the federal rules, policies, and pronouncements on the subject have not always been consistent or clear. The article endeavors to resolve issues of interpretation or application of the anti-augmentation principle where possible, based not only on the words that have been used to express the principle, but also on the rationale that appears to underlie it. One of the objectives of the article is to identify mechanisms of supplemental or variable researcher compensation that either are or should be acceptable to federal sponsors.

The distinction between "are acceptable" and "should be acceptable" is important, because the fact that a supplemental or variable compensation arrangement "should be" acceptable to federal sponsors on grounds of policy and logic does not necessarily mean that it will be. This article argues that federal policy on supplemental and variable compensation is in some respects too restrictive. Unless and until the policy is liberalized, however, grantees must operate within the boundaries of the policy as it currently exists—uncertain as those boundaries are in some respects.

Section 2 of this article summarizes the main federal rules, policies, and pronouncements that pertain to supplemental and variable compensation arrangements, and proposes a synthesis of those sources of authority and guidance. Section 3 applies the authority and guidance discussed in Section 2 to a number of different types of compensation arrangements, discussing how the arrangements would be or should be analyzed.

2. Applicable Federal Grant Rules and Policies

a. OMB Circular A-21

Section J.10.d(1) of OMB Circular A-21, *Cost Principles for Educational Institutions*, contains the one clear "rule" on the subject of supplemental and variable compensation, and other parts of Section J.10 contain provisions that are relevant to the subject. The cost principles applicable to nonprofit organizations and hospitals do not contain these same provisions, but it seems likely that these other categories of federal grantees would be held to the same standards on salary augmentation as colleges and universities are.

(1) Base salary rate limitation. The principal authority in OMB Circular A-21 for the federal policy on supplemental research compensation is the following language in Section J.10.d(1) of the Circular:

(1) Salary rates for academic year. Charges for work performed on sponsored agreements by faculty members during the academic year will be based on the individual faculty member's regular compensation for the continuous period which, under the policy of the institution concerned, constitutes the basis of his salary. Charges for work performed on sponsored agreements during all or any portion of such period are allowable at the base salary rate. In no event will charges to sponsored agreements, irrespective of the basis of computation, exceed the proportionate share of the base salary for that period. This principle applies to all members of the faculty at an institution.

To appreciate the full meaning of this provision, it is necessary to understand two key terms: "base salary" and "proportionate share." Neither term is defined in OMB Circular A-21, but their meanings are fairly clear from the context of Circular A-21's Section J.10.

The quoted A-21 language equates the "base salary rate" with the faculty member's "regular" compensation. The term "regular compensation" is not defined either, but in context it appears to mean the compensation that the faculty member would earn under the usual compensation policy of the grantee, without consideration of special or additional work. Usually it will be easy enough to identify "base salary," because in most supplemental compensation arrangements "base" and "supplemental" compensation are explicitly identified and distinguished by the institution itself.

"Proportionate share" is the share of base salary that corresponds to the proportion of total effort expended on the federal sponsored project. For example, if a researcher's regular salary for an annual period is \$100,000, and he spends 25 percent of his effort during the period on a federal grant, the proportionate share of the base salary allocable to the grant is 25 percent of \$100,000, or \$25,000.

Assume now that the faculty member receives a second federal grant, and he increases his total university effort in order to spend as much time on the second grant as on the first. After the award of the second grant, the "proportionate shares" of total effort for the two grants are only 20 percent, because the faculty member's total effort has expanded to accommodate the new work on the second grant. For example, if he was initially working 40 hours a week, of which 10 hours a week were spent on the first grant, then he

would have to add 10 hours a week to his total workload to spend the same amount of time on the second grant as on the first. His total hours per week would then be 50, so for each grant, the "proportionate share" would be 10 divided by 50, or 20 percent.

It would be impermissible salary augmentation in this case for the grantee to use the new salary support from the second grant to increase the faculty member's salary, and to use that salary as the basis for charging federal awards. Using the terminology of Circular A-21, the proper charges to the two federal grants would be as follows:

Base salary rate:	\$100,000
First grant's proportionate share of base salary (after receipt of second grant):	20 percent or \$20,000
Second grant's proportionate share of base salary:	20 percent or \$20,000

Under a typical salary augmentation arrangement, by comparison, the faculty member's salary would increase to \$125,000, each grant would be charged \$25,000 (based on a 20 percent proportionate share of the new salary), and the additional \$25,000 received under the second grant would be used to fund the \$25,000 increase in salary. The government would contend that this arrangement results in an overcharge to the sponsor of \$5,000 on each of the two grants—the difference between the \$25,000 actually charged and the \$20,000 permitted to be charged. In fact, in some actual cases, the government has at least initially taken the position that the entire amount of salary augmentation—\$25,000 in this example—represents an overcharge that must be refunded to the government. This is not a defensible position, since the actual "overcharge" to the government does not exceed \$10,000.

As noted, neither OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, nor the federal cost principles for hospitals, 45 C.F.R. Part 74, Appendix E, contains an express base salary rate limitation similar to that set forth in Circular A-21. It is unlikely, however, that federal sponsoring agencies would apply a different rule on salary supplementation to nonprofits and hospitals than the Circular A-21 rule that applies to educational institutions. Indeed, the National Institutes of Health and National Science Foundation policies on salary supplementation, discussed below, apply to all categories of grantees.

(2) Compensation for intra-university consulting. Extra compensation for intra-university consulting on sponsored projects is a form of salary supplementation that is expressly addressed by Circular A-21. As a practical matter, however, the use of this mechanism is tightly circumscribed, and as a result it does not provide a useful solution to the kinds of problems identified in this article. Under Section J.10.d(1) of Circular A-21, such extra compensation is not allowable as a charge to a federal project except in "unusual cases."

Since intra-university consulting is assumed to be undertaken as a university obligation requiring no compensation in addition to full-time base salary, the principle also applies to faculty members who function as consultants or otherwise contribute to a sponsored agreement conducted by another faculty member of the same institution. However, in unusual cases where consultation is across departmental lines or involves a separate or remote operation, and

the work performed by the consultant is in addition to his regular departmental load, any charges for such work representing extra compensation above the base salary are allowable provided that such consulting arrangements are specifically provided for in the agreement or approved in writing by the sponsoring agency.

The fact that a separate additional consulting fee is unallowable does not mean that time and effort spent on intra-university consulting may not be charged to a federal sponsored project. For example, assume that faculty member A, who has a base salary of \$100,000, spends 20 days a month on her regular departmental responsibilities, and consults for one additional day a month on a colleague's NIH grant. The colleague budgets a consulting fee of \$5,000 for the budget year—an amount that is in proportion to the one day a month spent. The \$5,000 could not be charged to the NIH grant as extra compensation unless one of the "unusual" circumstances identified in Circular A-21 was present. It still would be possible, however, to charge the NIH grant for a portion of A's base salary of \$100,000. Faculty member A's consulting effort of one day a month represents 1/21, or 4.8 percent, of her total university effort of 21 days per month. It therefore would be permissible for the grantee to charge 4.8 percent of A's \$100,000 salary, or \$4,800, to the NIH grant. In that case, the \$4,800 salary charge would be included in the "salary" portion of the proposal budget, not "below the line" as a consulting payment.

(3) Compensation for incidental work. Circular A-21 also expressly addresses compensation for "incidental work"—defined as work "in excess of normal for the individual."

Incidental work (that in excess of normal for the individual), for which supplemental compensation is paid by an institution under institutional policy, need not be included in the payroll distribution systems described below, provided such work and compensation are separately identified and documented in the financial management system of the institution. [Section J.10.a]

The most significant aspect of this provision is the acknowledgment that additional compensation may in some circumstances be paid for work that is "in excess of normal for the individual." The statement that incidental work and compensation "need not be" included in the payroll distribution system implies that such work and compensation may be included in the payroll distribution system if the grantee chooses to do so. As discussed below, however, informal DHHS and NIH interpretations of the "incidental work" concept appear to limit it to those relatively rare instances of chargeable intra-university consulting.

(4) Summer salary. Colleges and universities do not generally think of summer salary as "supplemental compensation," but in a literal sense it is, because it is compensation that a faculty member receives in addition to his or her base salary. Moreover, it is instructive to consider summer salary as a form of supplemental compensation, because doing so helps us to understand that there are some cases in which the federal government allows itself to be charged for supplemental compensation. It is very well accepted by federal sponsors

that faculty who have academic year appointments of fewer than 12 months may earn additional compensation by working on sponsored projects during the months that are outside the appointment (usually summer months). Circular A-21 expressly recognizes the concept of summer salary in Section J.10.d(2). This is clearly a case of supplemental compensation being paid solely as a result of an award of a new sponsored project, but the federal anti-augmentation policy does not prohibit summer salary because the supplemental salary is paid for effort that is demonstrably and objectively above and beyond the scope of the academic year appointment. This is a very important principle, which could have application in other contexts.

(5) Compensation for part-time work. Circular A-21 also recognizes that compensation may be increased or reduced to reflect changes in a faculty member's FTE (full-time equivalent) status:

Part-time faculty. Charges for work performed on sponsored agreements by faculty members having only part-time appointments will be determined at a rate not in excess of that regularly paid for the part-time assignments. For example, an institution pays \$5000 to a faculty member for half-time teaching during the academic year. He devoted one-half of his remaining time to a sponsored agreement. Thus, his additional compensation, chargeable by the institution to the agreement, would be one-half of \$5000, or \$2500. [Section J.10.d(3)]

Although this example is not crystal clear, the reference to "additional compensation" for work on a sponsored agreement suggests that the faculty member has received a form of supplemental compensation, over and above the \$5,000 he received for teaching, because of his work on a new sponsored agreement. Supplemental compensation is permissible in this circumstance because the faculty member's appointment status has changed—from a half-time appointment (0.5 FTE) devoted solely to teaching, to a three-quarters time appointment (0.75 FTE) devoted to teaching and research. As in the case of summer work and summer salary, the scope of the faculty member's appointment has increased, justifying a corresponding increase in compensation. Again, this provision illustrates the principle that compensation may vary in some circumstances where there has been an objectively determinable change in workload. Although in theory this principle might also be applicable to circumstances other than summer work or part-time work, the question in each case will be how to demonstrate that there has been an objectively determinable change in total workload.

b. National Institutes of Health (NIH) policy

Both the NIH and NSF have elaborated on the basic A-21 salary supplementation rule with language of their own. The NIH *Grants Policy Statement* (October 2010) defines "institutional base salary" as follows:

The annual compensation paid by an organization for an employee's appointment, whether that individual's time is spent on research, teaching, patient care, or other activities. Base salary excludes any income that an individual is permitted to earn outside of duties for the applicant/grantee organization. Base salary may not be increased as a result of replacing

organizational salary funds with NIH grant funds. (Emphasis added.)

The NIH language quoted above uses both the term "institutional base salary" and the term "base salary." The two terms are interchangeable in NIH usage, and they appear to have the same meaning as the term "base salary" as used in Circular A-21.

It is worth noting that this statement of NIH policy by its literal terms prohibits salary augmentation only where salary is increased as a result of the receipt of "NIH grant funds." The "base salary rate" language in Circular A-21 (see Section 2.a) does not contain this limitation, and it seems unlikely given the rationale behind the policy that NIH would accept an augmentation funded by a new non-NIH award.

c. National Science Foundation (NSF) policy

The NSF *Proposal and Award Policies and Procedures Guide* (January 2010) states:

NSF award funds may not be used to augment the total salary or salary rate of faculty members during the period covered by the term of faculty appointment or to reimburse faculty members for consulting or other time in addition to a regular full-time organizational salary covering the same general period of employment. Exceptions may be considered under certain NSF programs, e.g., science and engineering education programs for weekend and evening classes, or work at remote locations. If anticipated, any intent to provide salary compensation above the base salary must be disclosed in the proposal budget, justified in the budget justification, and must be specifically approved by NSF in the award budget. (Emphasis added.)

Like the NIH policy (see Section 2.b), the NSF policy appears on its face to prohibit salary augmentation only where salary is increased as a result of the receipt of "NSF award funds."³ Again, this limitation does not appear in the "base salary rate" language of Circular A-21.

d. National Science Foundation audits

NSF auditors have cited and applied the NSF anti-augmentation policy in at least two audits. The first was "San Diego State University Foundation, Overload Compensation," OIG Report 04-1-002, March 2, 2004. The second was "Howard University Needs to Improve Internal Controls Over Management of NSF Funds," OIG Report No. 06-1-008, March 31, 2006. The San Diego State University Research Foundation audit is of particular interest because it involved a disagreement between the audited institution and the auditors as to whether the research compensation that was reimbursed by NSF related to activity that was within the scope of the researchers' regular university appointments.

³ Statements of the NSF policy that appeared in earlier versions of the NSF Grant Proposal Guide were not expressly limited to augmentation from NSF grants, although that may have been the intent—e.g.: "Grant funds may not be used to augment the total salary or rate of salary of faculty members during the period covered by the term of faculty appointment." (2001 Grant Proposal Guide).

e. 1997 DHHS Office of Audit Resolution and Cost Policy letter

Another source of authority on supplemental compensation arrangements is not well-known, but it is significant because it expressly allows supplemental compensation in certain circumstances. In October 1997, the DHHS Office of Audit Resolution and Cost Policy, whose mission was in part to serve as a source of federal cost policy guidance for DHHS-cognizant grantees, issued an opinion supporting salary supplementation if the following conditions were met:

1. The institution establishes uniform, consistent policies which apply uniformly to all employees of a given class, not just those working on federal projects.
2. The institution establishes a consistent definition of a full-time workload which is specific enough to determine conclusively when work beyond that level has occurred.
3. The supplementation policy is consistently followed for all employees who qualify, not merely those who work on federal projects.
4. The supplementation amount paid is commensurate with the base pay rate and the amount of additional work performed.
5. The salaries, as supplemented, fall within the salary structure and pay ranges established by or otherwise applicable to the institution.
6. The total salaries and workload as supplemented are considered as the full activity of the individuals and thus constitute 100 percent of effort under the activity reporting system prescribed by [Section J.10] of Circular A-21.

Letter from Joseph E. Cook Jr., Director, DHHS Office of Audit Resolution and Cost Policy, Oct. 3, 1997 (citations omitted).

The DHHS letter goes on to address the "incidental work" language in what is now Section J.10.a of Circular A-21. It states (without reference to any other authority) that incidental work "does not include administrative activities, direct effort on sponsored agreements (except intra-university consulting arrangements . . .) or any other activities which are part of an individual's regular assignments."

The DHHS letter was never published as official DHHS policy, and cannot be considered binding either on DHHS or on DHHS grantees. It is useful, however, as an indication of DHHS's interpretation, at least as of 1997, of certain key provisions of Circular A-21.

f. 2005 AAMC Conference Call with NIH

A final significant source of authority, albeit informal and unofficial, appears in a set of written questions and answers documenting a Feb. 10, 2005, AAMC-sponsored conference call with a representative of AAMC and the director of NIH's Office of Policy for Extramural Research Administration (OPERA). As noted earlier, the answers in the Q&A document are not expressly attributed to the NIH official, but they are believed to be consistent with his views. In this article the positions expressed in the document will be referred to as positions of NIH, although it should be stressed that they are not official pronouncements of NIH policy.

The AAMC Q&A document contains several important comments on research salary supplementation, which merit quoting at length:

Question 12: "In what circumstances can an institution increase a faculty member's existing Institutional Base Salary based on receipt of a new grant award that provides support to the faculty member's salary?"

Grant funds can replace, not increase, a faculty member's salary. A-21 requires that to be allowable, a cost has to be, among other things, reasonable. And "reasonable" includes being consistent with established institutional policies that are applicable to the work of the institution generally, including sponsored agreements—not just sponsored agreements. In other words, institutional policies cannot provide for salary increases based only on receipt of Federal grant support.

To repeat, an institution can't increase salary simply because part or all of the effort is now charged to a Federal award, assuming that the duties are essentially the same. Institutions can adjust compensation based on past performance and current responsibilities if the adjustment is done on a consistent basis, regardless of the source of support. Therefore, the faculty member's IBS [Institutional Base Salary] can be reevaluated the next time these levels are set by the institution.

Question 13: "There's been quite a bit of discussion recently about salary supplements—when they can and when they must be included in Institutional Base Salary. They come in many forms—bonuses, administrative overload pay, supplements for teaching extra courses, interdepartmental consulting on grants, research supplements, variable components of salary contingent on external support, etc., etc. What guidance can you give us in dealing with these different forms of supplemental compensation? Is the Government working on any official written guidance in this area?"

The NIH Grants Policy Statement indicates that bonus funds and incentive payments are "allowable as part of a total compensation package, provided such payments are reasonable and are made according to a formal policy of the grantee that is consistently applied regardless of the source of funds." The Statement also says that overtime premium payments "are not allowable for faculty members at institutions of higher education." Translating these principles into an ABC salary system, the A component, which may be called "base salary," is includible in the calculation of IBS. The B component, often called the "incentive component," is also includible in the calculation of IBS, provided it is set in advance and awarded according to institutional policy, consistently applied regardless of source of funds (that is, not awarded solely on the basis of federal grant-getting prowess). The C component, or, for example, an after-the-fact variety of bonus or incentive payment, would not be includible in IBS, because it was not set in advance and is not part of the regular commitment of the institution for the salary period in question. Finally, the supplements for doing extra work appear not to be allowable for faculty members. Interdepartmental consulting is addressed in the Grants Policy Statement as follows:

"In unusual situations, a person may be both a consultant and an employee of the same party,

receiving compensation for some services as a consultant and for other work as a salaried employee as long as these separate services are not related to the same project and are not charged to the same project. For example, consulting fees that are paid by an educational institution to a salaried faculty member as extra compensation above that individual's base salary are allowable, provided the consultation is across departmental lines or involves a separate or remote operation and the work performed by the consultant is in addition to his or her regular departmental workload."

To summarize, it depends on the circumstances for bonuses and administrative overload pay. For supplements for teaching extra courses, such supplements are unlikely to be applicable to NIH awards. For interdepartmental consulting on grants, it may meet the definition of "incidental work (that in excess of normal for the individual), for which supplemental compensation is paid . . . need not be included in payroll distribution systems." Research supplements are suspect, and variable components of salary contingent on external support appear plainly unallowable to NIH/Federal awards.

Because the foregoing statements were made in a somewhat informal setting, they cannot be parsed for legal significance to the same degree as language in a formal government rule or policy. Subject to that qualification, there are several aspects of these statements that are worthy of comment:

Response to Question 12:

- NIH expressly links the anti-augmentation policy to the requirement that salary costs be reasonable. The "reasonableness" rationale, however, is in turn linked in NIH's response solely to the issue of consistency—i.e., a salary adjustment cannot be reasonable if it can be based on the receipt of research funding but cannot be based on other non-research factors. Does this mean that if a grantee allows mid-year adjustments in salary based on taking on new administrative duties, or an increased course load, then it also could allow mid-year adjustments in salary based on newly awarded research support? It seems doubtful that that was NIH's meaning, but its stated rationale for the anti-augmentation policy suggests as much.
- NIH states that "To repeat, an institution can't increase salary simply because part or all of the effort is now charged to a *Federal award* . . . (emphasis added)." Does this mean that the salary used to charge NIH grants may be augmented by salary support received under a newly awarded non-federal award?
- NIH states that salary augmentation is impermissible "assuming that the duties are essentially the same." This important qualification appears to leave the door open to augmentation where there has been an objectively identifiable and documented increase in the researcher's appointment duties. More will be said on this subject below.
- NIH states that "the faculty member's IBS [Institutional Base Salary] can be reevaluated the next time these levels [i.e., researchers' salary levels] are set by the institution." This statement sug-

gests that adjustments in salary—even adjustments based on research productivity—are permissible if they take place at the periodic times (usually yearly) set in the grantee's compensation policy for reevaluating salary. Elsewhere, NIH makes it clear that, for consistency purposes, such periodic adjustments in salary also must be available based on non-research considerations, but even so, this is an important principle because it establishes a limited safe haven for recognition of research productivity in setting salaries.

Response to Question 13:

- NIH states that an incentive component of salary may be allowable "provided it is set in advance and awarded according to institutional policy, consistently applied regardless of source of funds (that is, not awarded solely on the basis of federal grant-getting prowess)." The consistency principle has been noted earlier; what is most noteworthy about this statement is the reference to a requirement that the component be "set in advance." There does not appear to be any express authority for the "set in advance" requirement, and its meaning is not entirely clear. It is sometimes said that NIH will accept a salary component as part of chargeable base salary only if it is "guaranteed" for the salary period (usually one year), and the "set in advance" criterion may derive from this "guarantee" requirement. There is, however, no express authority for the "guarantee" requirement either, and the relationship between the "set in advance" criterion and the "guarantee" criterion is uncertain. The fact that a salary component is "set in advance" does not necessarily mean that it is guaranteed. For example, an incentive component of salary based in part on availability of grant support could be set in advance at a certain dollar amount, but the component still could be reduced or eliminated if the expected performance levels are not achieved. The conservative interpretation of these terms would be that in NIH's parlance "set in advance" means "guaranteed," or at least "guaranteed as long as the scope of the appointment remains unchanged." This interpretation is supported somewhat by NIH's reference to the variable "C" component of salary, which is said to be "not set in advance and is not part of the regular commitment of the institution for the salary period in question." (Emphasis added.) The introduction of the word "commitment" here suggests that a commitment or guarantee is intertwined with the concept of "set in advance."
- NIH also states that, "Finally, the supplements for doing extra work appear not to be allowable for faculty members." Some care should be taken in interpreting this statement. It is unlikely that it was intended as a broad prohibition of any payment of a supplement to a faculty member for doing extra work. For example, compensation supplements for extra work during the summer months are clearly permissible under Circular A-21. Most likely this sentence was a reference to the provision in the NIH Grants Policy Statement that overtime payments are not allowable for faculty members at institutions of higher education. Supplemental payments that are merely payments

for extra hours of work, such as overtime payments, are not allowable for faculty, because faculty appointments are generally not defined in terms of commitments of hours. That does not necessarily mean, though, that supplemental payments made in recognition of added duties or an increased appointment of a faculty member would not be allowable. In fact, the statement in question is followed by two examples of types of supplemental payments to faculty members that are sometimes allowable—payments for intra-university consulting and payments for incidental work.

- NIH concludes its response by stating that “Research supplements are suspect, and variable components of salary contingent on external support appear plainly unallowable to NIH/Federal awards.” The use of the word “suspect” in the first part of this statement, as compared with the phrase “plainly unallowable” in the second part, suggests that there may be circumstances in which a research supplement would be allowable. Even the words “plainly unallowable” in the second part of this statement must be read with care, because NIH has separately acknowledged that there may be variability in compensation related to external support, where the scope or magnitude of the faculty member’s appointment has changed.

g. False Claims Act settlements involving salary augmentation

In the past five years there have been three publicly reported university False Claims Act settlements in which allegedly improper salary supplementation was one of the issues investigated by the Department of Justice. These settlements were announced in January 2006, July 2008, and June 2009. As is usually the case, the public documents relating to these settlements reveal relatively little about the facts of the cases or the positions of the government and the affected university. The settlements are not particularly useful, therefore, as guides to understanding the federal rules and policies on salary augmentation. The settlements do serve as a reminder, however, that failure to observe the federal anti-augmentation policy can at least in some circumstances result in enforcement action under federal fraud statutes, with the attendant risk of civil penalties, administrative sanctions, and reputational harm.

h. Synthesis of federal policy on salary augmentation

From the foregoing collection of federal authorities on supplemental and variable compensation arrangements, it is possible to discern a number of factors that likely will—or will not—enter into a determination of the allowability of any given arrangement:

- (1) **Reasonableness.** Although the only stated purpose of the federal anti-augmentation policy appears to be to ensure that researchers’ salaries charged to federal awards are reasonable, it seems unlikely, given the current federal mindset on this subject, that a supplemental or variable compensation arrangement can be defended solely on the ground that it produces a demonstrably reasonable salary level. For example, a midyear augmentation of a faculty member’s salary based solely on receipt of a new federal award likely would be re-

jected by the federal government even if the new salary were clearly consistent with the “market” rate for compensation of similarly qualified faculty members. It is possible, however, that a government attempt to recover damages based on a violation of the anti-augmentation policy could be successfully opposed by proving that the government was not damaged because the challenged arrangement did not result in unreasonable salary charges.

- (2) **Basic principle.** The core principle of the federal anti-augmentation policy is that a researcher’s base salary—namely the salary that is used to charge federal sponsored agreements—may not be increased midyear solely because the researcher has new grant funding that supports more of his or her base salary. As noted above, the Circular A-21 version of this principle is unqualified—the base salary rate is the ceiling for charging federal sponsored agreements regardless of the source of funding for any proposed supplement. The NIH policy, however, suggests that the anti-augmentation policy is violated only where the supplement would be funded by an NIH award, and the NSF policy restricts only the funding of supplements from NSF awards. It is uncertain that these apparent limitations in the NIH and NSF policies are intended. The basic principle stated above must be qualified by the observation that salary supplements are permitted where they are associated with clear and well-documented increases in a researcher’s appointment or duties. Similarly, a variable compensation arrangement may be justified where the variations are associated with documented variations in appointment scope.

- (3) **Periodic salary-setting in accordance with institutional policies.** One limited “safe haven” in the salary supplementation area is the ability of grantees to adjust researchers’ salaries either up or down as part of the periodic (usually annual) salary review process stipulated in the grantee’s compensation policies and procedures. This safe haven is limited in several important respects. First, for consistency purposes the opportunity to receive upward adjustments must be available not only for research performance, but also for performance in non-research areas. This would mean, for example, that a salary adjustment process based solely or predominantly on formulaic measures of external grant support might not pass muster. Second, the salary that emerges from the periodic salary-setting policy must not be indefinite; it must be “set in advance” and apparently must be “committed” to by the grantee. Whether this literally means that there must be no circumstances in which the salary may be reduced midyear is uncertain. Third, of course the salary must be objectively reasonable in relation to the market and the merit of the individual researcher, although as noted above, reasonableness alone will not justify an otherwise “suspect” research supplement. With these qualifications, it seems clear that a grantee may legitimately take research productivity into account in setting researchers’ salaries as part of its annual or other periodic salary-setting process.

- (4) **Adjustments based on documented changes in appointments or duties.** Although the federal anti-augmentation policy is often expressed in absolute terms, it is clear that there is one major exception to it. Grantees are permitted to supplement or vary compen-

sation based on changes in the appointment status or appointment responsibilities of researchers, or where a researcher is otherwise demonstrably performing functions over and above his or her regular appointment or assigned workload, or performing at a specified level below his or her regular appointment. Some of these grounds for supplementation or variation are expressly identified in Circular A-21 or other sources of authority—e.g., compensation for summer work, part-time arrangements, intra-university consulting, and compensation for incidental work. Some of these express exceptions may well involve research activity—compensation for summer effort certainly does in most cases. In addition to these references in Circular A-21, the authorities collected above contain several references to the possibility of supporting supplemental compensation in some circumstances. The challenge, of course, is to fashion a supplemental or variable compensation arrangement that adequately addresses the government's concerns about such arrangements. This challenge is addressed in Section 3, primarily in the discussion of the Type B arrangement.

(5) No adjustment in salary used to charge federal awards. There is one final point to be made in this synthesis of the federal anti-augmentation policy, and it is a point that is often overlooked. The federal policy against research supplements does not restrict the salary that a faculty member may *earn*; it restricts only the salary that may be *charged* to federal awards. Thus, if a faculty member's base salary is \$75,000 and he or she receives a federal grant award that provides \$25,000 in new salary support, the anti-augmentation policy would not prohibit the grantee from using all or part of the newfound \$25,000 to augment the faculty member's total compensation. Whatever the new compensation level, however, the salary rate that could be used to charge the new federal award could not exceed the original \$75,000 base salary, and the amount charged could not exceed the proportionate share of that base salary. If the new award takes up 20 percent of the faculty member's total institutional effort (including the effort on the new award), then the new award can be charged \$15,000 (20 percent of \$75,000) on an annual basis. The fact that the faculty member's total compensation may have been increased to \$100,000 would not justify charging the new award 20 percent of \$100,000, or 20 percent of any other salary amount in excess of the \$75,000 base salary.

3. Application of the Anti-Augmentation Policy to Different Types of Supplemental or Variable Compensation Arrangements

Armed with the foregoing collection of federal authorities and other guidance and the proposed synthesis of that guidance set forth in Section 2, we may now turn more directly to applying the anti-augmentation policy to actual compensation arrangements.

There are, as may be expected, an almost endless number of different types of supplemental or variable compensation arrangements, conceived for many different purposes. The six basic types of arrangements discussed below, however, are generally representative.

A. Type A: "Classic" salary supplementation based on receipt of new research support.

Example: Faculty member A has a 12-month full-time appointment at a base salary of \$96,000. This base sal-

ary was set during A's most recent annual salary review, and is consistent with A's qualifications, experience, and productivity. It is also consistent with the compensation of other faculty in his discipline who have similar credentials.

Faculty member A receives a new NIH award that pays for two additional months of salary (\$16,000 at the \$96,000 rate). The university, recognizing that the new federal award "frees up" \$16,000 that the university formerly paid to A out of its own funds, increases A's base salary by \$16,000, to \$112,000.

Federal grants are now charged for A's salary at the rate of \$9,333/month (\$112,000 divided by 12 months). This is an increase from the prior monthly salary charge to grants of \$8,000 per month (\$96,000 divided by 12 months).

NIH likely would contend that under its policy, the increase from \$8,000/month to \$9,333/month is impermissible salary augmentation, because the NIH award has been used to augment A's base salary.

Discussion: This example illustrates what might be considered a "classic" case of salary augmentation based on receipt of new federal grant funding. Faculty member A's appointment status has not changed; he was a full-time faculty member before the receipt of the new federal award, and a full-time faculty member afterward. His base salary has increased solely because of the receipt of the new federal award, and it has increased to a level that is \$16,000 a year higher than A's merit-based salary, set in accordance with the university's regular compensation policy. NIH would contend that the increase violates the NIH policy that, "Base salary may not be increased as a result of replacing organizational salary funds with NIH grant funds."

If the new federal award had been an NSF award, NSF too likely would contend that impermissible salary augmentation had occurred, in violation of NSF's policy that "NSF award funds may not be used to augment the total salary or salary rate of faculty members during the period covered by the term of faculty appointment."

Under a literal reading of the NIH policy, it is unclear whether NIH would consider that impermissible salary augmentation had occurred if an NIH award were not the source of the augmentation. The same uncertainty exists with respect to the current NSF policy. It seems likely, however, that these policies would be applied to salary augmentation based solely on the receipt of a new grant award, regardless of the source of the award.

B. Type B: Reduced compensation arrangements.

Example: Faculty member B has a 12-month full-time appointment at a base salary of \$96,000. This base salary was set during B's most recent annual salary review, and is consistent with B's qualifications, experience, and productivity. It is also consistent with the compensation of other faculty in her discipline who have similar credentials.

One of B's federal grants expires, causing her to lose two months of salary support, amounting to \$16,000 of lost support. No bridge funding is available, so her annual compensation rate is temporarily reduced to \$80,000 a year. Her university base salary of \$96,000 remains unchanged, but she is deemed to be temporarily "without compensation" for one-sixth of her full appointment (two months divided by 12 months).

B continues to devote one month per year to another existing federal award. Both before and after the com-

pensation reduction, that award is charged \$8,000 for B's salary.

B writes a proposal for a new federal award, under which she proposes to provide two months of effort per year. She requests salary support of \$16,000, which is the proportionate share (two-twelfths) of her base salary of \$96,000.

Three months later B receives the new federal award, which provides two months (\$16,000) of salary support. The university restores B's compensation rate to \$96,000. Following the restoration, federal grants are charged for B's salary, based on a proportionate share of the original salary rate of \$8,000 per month.

Discussion: This arrangement clearly has features that raise questions under the federal policies against salary augmentation. Among other things, the arrangement involves an increase in compensation that appears to be directly tied to an increase in federal salary support—even though the compensation increase merely restores the faculty member to her original base salary level. Before addressing the technical issues raised by this arrangement, however, it is worthwhile to step back and try to appreciate the university's perspective on this situation.

When external research funding of a researcher disappears or fails to materialize, the researcher's employer has only three options: (1) find new sources of funding to "bridge" the salary gap created by the loss of external research funding, (2) terminate the researcher's employment, or (3) temporarily reduce the researcher's compensation until new external funding can be secured. The "bridge funding" option is becoming less and less viable, especially in these days of tightening institutional budgets. The second option—terminating the researcher's employment—is not only drastic and very painful to all concerned, but also highly impractical. There is no way for any research institution to time the recruitment, hiring, termination, and replacement of qualified researchers so that the institution will always have just the right number of researchers with just the right qualifications to perform the available sponsored projects, and just the right amount of external support from those projects. Terminating well-qualified researchers with the expectation of being able to rehire them a few months later on a "just in time" basis, when new external funding appears, obviously is not a realistic business model.

That leaves option three—temporarily reducing the salaries of researchers who have gaps in external funding. By using this option, the institution is effectively shifting at least some of the risk of fluctuations in research funding to the researchers themselves. From an individual researcher's perspective, a salary reduction is hardly welcome, but it is at least preferable to termination. From the institution's perspective, the ability to scale faculty compensation to keep it consistent with available external funding greatly reduces the risk that otherwise would be associated with hiring new research faculty.

Speaking more broadly, there is a strong public policy argument in favor of allowing research institutions to mitigate the risk of funding fluctuations in this way. Without the "reduced compensation" option, research institutions would be forced to guarantee salary based on the mere expectation of research support, which may or may not materialize or continue. Faced with having to make such a guarantee, many institu-

tions would be less willing and able to hire new research faculty, to the detriment of their research mission and the public interest in research. As noted above, the decreasing availability of internal funds for the support of sponsored research makes this problem all the more acute—institutions have much less ability today than they have had in the past to cover shortfalls in external funding through other sources of institutional funding. State institutions, whose appropriated funds may in some cases be restricted to the support of instruction, are sometimes particularly limited in this regard, but many private institutions face exactly the same problem.

In short, "reduced compensation" arrangements such as the one described in the example above appear to be a reasonable and practical response to a difficult situation. They benefit the institution by allowing it to mitigate the risk of fluctuations in external research funding. They benefit the researchers by providing a mechanism that allows them to remain employed during temporary downturns in grant support. And they benefit the government and the public by enabling institutions to take on new research faculty and expand their research enterprise without incurring the risk of guaranteed salaries that cannot be externally funded, and without allowing salaries to increase beyond reasonable, market-based levels.

Unfortunately, sometimes good policy is one thing, and rules are another. The example set forth above raises several potential issues of compliance with federal grant policies, including but not limited to the anti-augmentation policy:

- *Is any part of faculty member B's base salary allowable at all, since it is subject to midyear reduction and therefore not "guaranteed?"* The very fact that the university was permitted to reduce faculty member B's compensation from \$96,000 to \$80,00 in the middle of a salary year demonstrates that the \$96,000 was not "guaranteed" in the literal sense of that word. In informal discussions of faculty salary arrangements, both government and grantee personnel often use words that suggest that a non-guaranteed salary, or a portion of salary, that is contingent on a continuing level of external grant support may not be considered "regular" or "base salary" and therefore may not be allowable as a basis for charging federal sponsored agreements. For example, in the 2005 AAMC conference call discussed above in Section 2.f, the NIH representative seemed to suggest that a salary component was not allowable as a part of "base salary" because "it was not set in advance and is not part of the regular commitment of the institution for the salary period in question." The phrase "set in advance" and the word "commitment" both seem to suggest that the salary component must be guaranteed in order to be allowable.

In the context of a reduced compensation arrangement such as the Type B arrangement, however, there are at least three possible responses to be made on this issue. First, neither the federal cost principles nor the NIH or NSF policies on salary augmentation expressly state that salary must be "guaranteed" for the salary year in order to be allowable. Second, in the example, B's base salary unquestionably was "set in advance" and was part

of the university's "regular commitment" to her—as base salary typically is, almost by definition. The fact that B's compensation was later reduced reflects an unexpected and non-routine circumstance—the lack of sufficient external funding to pay the full, regular base salary that the university otherwise was committed to pay. Third, the requirement of a "guarantee," if such a requirement in fact exists, should not apply where a reduction in compensation results from a reduction in a faculty member's appointment or appointment responsibilities. For example, if a faculty member's appointment were to be reduced from full-time to part-time, with a corresponding reduction in compensation, the compensation reduction would hardly be inconsistent with characterizing the original full-time salary as "guaranteed." Although faculty member B in the example did not become a part-time employee, the university's support for her activities has clearly been reduced. B's reduced compensation arrangement may be viewed as an example of an arrangement under which compensation is adjusted downward and later upward based on adjustments to a researcher's appointment or appointment responsibilities.

■ *Is it permissible to charge B's remaining federal award \$8,000 after the reduction in compensation?* B's new compensation—at least the compensation actually paid to B—is only \$6,667 per month (\$80,000 divided by 12), and the example states that she is continuing to work one month per year on her remaining other federal award. This raises a question as to how the grantee can justify charging the award \$8,000 for one month of effort.

The \$8,000 per-month charge to the remaining federal award can be arrived at in either of two ways, given the one month per year that B continues to devote to the award:

(a) One month of B's new total effort represents 10 percent of B's total 10 months' "worth" of compensated effort (now that B is without compensation for the equivalent of two months). B's reduced annual compensation rate is \$80,000. Ten percent of \$80,000 is \$8,000.

(b) One month of B's effort represents one-twelfth of B's fully compensated, full-appointment effort of 12 months. B's fully compensated full-appointment effort is \$96,000. One-twelfth of \$96,000 is \$8,000.

Both of these methods of calculation are based on the premise that B's appointment has been reduced. Another way of presenting calculation (a) above is as follows:

	Effort percent before reduction	Effort percent after reduction
Lost federal award	17 percent	0 percent
Remaining federal award	8 percent	8 percent
All other university effort	75 percent	75 percent
Total appointment effort	100 percent	83 percent
Activity outside appointment	NONE	17 percent

After the compensation reduction, the effort on the remaining award is 8 percent, and total appointment effort is 83 percent of total effort. Effort on the remaining federal award, therefore, is 10

percent of the total appointment effort for which the \$80,000 in compensation is paid (8 percent divided by 83 percent).⁴

■ *Is it permissible to use B's base salary rate of \$96,000 in grant proposals, even though the university at the time is compensating B at the annual rate of only \$80,000?* This question is closely related to the preceding question. Generally speaking, grantees are required to base requests for salary support on the salaries that they actually are paying. Again, though, in the example there are two ways of looking at faculty member B's proposal. One is that her proposed two months would be 17 percent (2 months divided by 12 months) of a full-appointment effort. The other is that it is 20 percent of a reduced appointment effort (two-twelfths divided by ten-twelfths). Either way, the correct salary request would be \$16,000 (one-sixth of \$96,000 or one-fifth of \$80,000). If the first calculation approach is used, it may be advisable for the grantee to include an explanatory note to that effect in its budget justification. An example of possible language for such a note might be: "All salary amounts are based on full-FTE, full-appointment compensation. For researchers who have part-time or reduced responsibility appointments, with correspondingly reduced compensation, proposed effort is also expressed in relation to full-appointment effort, so the requested salary is consistent with proposed effort."

■ *Is it permissible to increase B's chargeable salary to \$96,000 after the receipt of new federal salary support?* This of course is the central question for purposes of this article, because it directly raises the question of whether the increase would violate the federal anti-augmentation policy.

There are two possible responses to this question. The first is that because the only purpose of the anti-augmentation policy is to ensure reasonable salaries, and because by the terms of the example B's salary rate never exceeds the reasonable, market-based, merit-based level of \$96,000, the anti-augmentation policy should not prohibit the restoration of B's salary to \$96,000 or the use of the \$96,000 as "base salary" for the purpose of charging federal awards. As a matter of logic and policy, this appears to be a very compelling argument. Unfortunately, however, there currently is no indication that federal sponsors are prepared to carve out a broad exception to the anti-

⁴ Please note that this calculation is based on some important assumptions about how faculty member B's "reduced appointment" is defined, and how B spends her time after her compensation is reduced. The subject of how to redefine appointments in the context of reduced compensation arrangements is a complex one, the details of which are beyond the scope of this article. For purposes of the calculations applicable to the faculty member B example in this article, it should be assumed that the 17 percent effort that B previously devoted to her lost federal award has been shifted to personal activities, or to activities that the university has expressly defined as being outside the scope of her reduced appointment. In that case, her appointment has effectively been reduced to an 83 percent appointment, and any activity on individual awards should be reimbursed based on the proportionate share of the effort on the awards relative to the 83 percent.

augmentation policy based on reasonableness alone.

The second possible response, which may or may not be available depending on the facts, is that the reduced compensation arrangement is tied to a reduced appointment or an appointment with reduced responsibilities. That characterization of the arrangement may be factually accurate at some institutions and not at others, and each instance must be assessed on its own facts and circumstances. In general, however, where a faculty member's compensation has been unilaterally reduced as a result of a reduction in an important activity (in B's case, the loss of a sponsored project), it would be natural for both the faculty member and the university to associate that reduction with a proportionate reduction in the faculty member's obligations to the university. That may be expressed in a variety of ways—as a reduced appointment, a reduction in appointment responsibilities, a reduced scope of activity—the exact words are less important than the concept. Where such an appointment adjustment results in a temporary compensation reduction, and the later receipt of grant support allows the university to restore a faculty member to a full appointment and full base salary, there is no apparent reason to deny the restoration of salary based on the anti-augmentation policy. Because in these circumstances the restoration of compensation results not merely from the receipt of new outside funding but from a change in appointment scope or status, the restoration is analogous to the receipt of summer salary based on extra summer work, or movement from a part-time to full-time status.

A grantee seeking to justify a restoration of compensation on the ground that it resulted from an appointment adjustment would have to be prepared to demonstrate that a true appointment adjustment actually occurred. A faculty member's appointment status is traditionally established through an appointment letter or some similar document, signed by a department chair, dean, or other university official with authority to authorize appointments. Ideally, the reduction and restoration of compensation in a reduced compensation situation would be supported by documentation of corresponding changes in the faculty member's appointment or appointment responsibilities. That is not to say that such documentation would have to take the form of an actual appointment letter, or any other particular form. In order to support the reduction and restoration of compensation, however, it would be important to have documentation that identifies each iteration of the faculty member's appointment in an objective manner, perhaps with estimated percentages of effort devoted to each appointment activity. The documentation should also be authorized by an appropriate university official with authority to adjust faculty appointments—not, for example, by a departmental clerical employee. There are many different ways that such documentation could be prepared, but whatever its form, it should be clear enough to satisfy an auditor that variations in compensation resulted from objective changes in appointment

status and not merely from shifts in available funding.

It is important to emphasize that the "variable appointment" concept described above is not expressly authorized by federal policy, and has not been tested in a federal audit or other review of university compensation charged to federal awards. Even if an institution is able to demonstrate that fluctuations in compensation resulting from such an arrangement are tied to objectively verifiable changes in university appointment responsibilities, it is quite possible that some government auditors or sponsors would object to the arrangement as a form of impermissible salary augmentation. The "variable appointment" concept does, however, offer a possible ground for defending reduced compensation arrangements where appointments have in fact been adjusted and the adjustments have been appropriately documented. Moreover, it does so in a way that ensures that chargeable compensation will never exceed the market-based regular compensation established under institutional compensation policies.

C. Type C: Salary set in advance, with a variable component based on research support.

Example: Faculty member C's salary is in two parts: (a) a "university base" of \$80,000 and (b) a "research supplement" of \$16,000. Both the university base and the research supplement are set in advance as part of the university's annual salary review process. The university base component is fixed for the year; the research supplement is also set for the year, although it is contingent on continuing salary support from sponsored projects during the year. The research supplement may be decreased midyear, but it cannot be increased beyond \$16,000 regardless of how much research faculty member C performs.

The total salary of \$96,000 is consistent with C's qualifications, experience, and productivity. It is also consistent with the compensation of other faculty in his discipline who have similar credentials.

The government might contend that the \$16,000 is an unallowable research supplement because, although it is "set in advance," it is not guaranteed for the salary year. Even if the \$16,000 is considered allowable, if grant support is lost midyear and the supplement is reduced accordingly, the government might contend that a midyear restoration of any of the reduced supplement based on the receipt of a new federal award is unallowable salary augmentation.

Discussion: This example does not involve salary augmentation in the classic sense, because the arrangement described does not result in an increase in compensation based on the receipt of new grant funding. There is a research supplement component to faculty member C's compensation, but that component is set in advance and may not increase midyear as a result of the receipt of new grant funding.

As discussed above in Section 2.f, there is no express authority for the often-stated proposition that, to be allowable as a charge to federal awards, a salary component must be fixed, committed, or guaranteed. The summary of the 2005 AAMC-sponsored conference call with NIH does contain the following statement, which relates to a somewhat different kind of arrangement than the Type C arrangement described above:

[T]he A component, which may be called "base salary," is includible in the calculation of IBS. The B

component, often called the "incentive component" is also includible in the calculation of IBS, provided it is set in advance and awarded according to institutional policy, consistently applied regardless of source of funds (that is, not awarded solely on the basis of federal grant-getting prowess). The C component, or, for example, an after-the-fact variety of bonus or incentive payment, would not be includible in IBS because it was not set in advance and is not part of the regular commitment of the institution for the salary period in question.

In this response the NIH representative most likely was referring to a common structure of compensation for clinical faculty members, who often receive a university base salary, a clinical component that is set in advance, and a variable clinical component that is not set in advance but varies depending on performance during the compensation period. This structure is often referred to as an ABC or XYZ structure. Although the quoted language refers to the B component as an "incentive component," the fact that it is set in advance means that it is not the kind of incentive that is determined after the fact. In fact, the statement that the C component is "not includible in IBS" because it is not set in advance and is an "after-the-fact bonus or incentive payment" seems to make it clear that NIH had in mind a B component that was fixed, at least in the sense that it cannot exceed the "set-in-advance" level.

Applying the quoted NIH language to the Type C arrangement, it is clear that the research supplement in the Type C arrangement is set in advance, like the B component of the salary structure described by NIH. Both apparently are fixed, in the sense that they cannot exceed the "set-in-advance" level. In the Type C arrangement, the research supplement may not be paid in full if the expectations on which it was based are not met. The quoted language from the NIH response does not make clear whether that is the case with the B component in the ABC structure described by NIH. The NIH comments quoted above, therefore, do not definitively establish whether or not the Type C arrangement would be acceptable to NIH.

There is one important distinction, however, between the Type C arrangement and the ABC structure described by NIH. In the Type C arrangement, the research supplement may be earned only by researchers; it is by definition not available to faculty who are not engaged in research. In the ABC structure described by NIH, by contract, the B component is "awarded according to institutional policy, consistently applied regardless of source of funds (that is, not awarded solely on the basis of federal grant-getting prowess)." This is an important distinction from the government's perspective. Federal sponsors in general are willing to reimburse grantees for salaries that the grantees have set in accordance with their normal salary-setting process. Where it appears, however, that recipients of research funding are being paid higher salaries simply because of the greater availability of external funding with which to pay such salaries, the government may disallow the higher salaries based on the principle of consistency.

The principle of consistency is easy to apply in extreme hypothetical cases, but more difficult to understand and implement in practice. To take a clear hypothetical case, assume faculty member X and faculty member Y both have the same "market value"—that is,

they can both command the same salary in the competitive market for faculty—but X is a researcher with funded projects and Y has no external funding. It presumably would be inconsistent, as the word "inconsistent" is normally used in this context, for their employer to pay X more than Y simply because external funds are available to pay X's salary but not Y's.

Most cases are not nearly so clear-cut, however. For example, it seems indisputable that a university employer is entitled to take research productivity into account in setting faculty salaries. The research dollars that a faculty member is able to attract and use in valuable research are a measure of achievement in their own right, but they also are a tangible contribution to the academic mission of the university and the support of more junior researchers, graduate students, and others. It would be hard to argue, all other factors being equal, that a faculty member who is highly successful in bringing in and performing grants is not more valuable to the university than a faculty member who does not. The fact that the research faculty member is in a field where external funding is available and the other faculty member is not does not change the fact that the former brings more value to the university than the latter—again, all other factors being equal. It is difficult to know how to apply the principle of consistency in setting compensation in such cases. Does the phrase "consistently applied regardless of the source of funds" mean that a university must disregard research productivity in setting salaries? If not, how much consideration can the university give to external support without violating the principle of consistency?

It might be argued that the Type C arrangement is an obvious case of inconsistency, because a "research supplement" by definition can be earned only by a faculty member engaged in research, and not by faculty members who excel in other academic areas. That may be so, but it would take only a few tweaks to the description of the Type C arrangement to make the application of the consistency principle much harder. For example, if the word "research" were removed from the term "research supplement," and non-research faculty became eligible to receive the supplement, what percentage of the recipients would have to be non-research faculty before the payment of the supplement could be said to be "consistently applied regardless of source of funds?" To take another example, what if research faculty member P and non-research faculty member Q have equal total "value," but P is paid a base salary of \$80,000 and a research supplement of \$20,000, whereas Q is paid a base salary of \$100,000. Only P had the opportunity to earn the research supplement, but if anything his salary deal is less favorable, since only \$80,000 of it is guaranteed. Has the supplemental salary policy been "consistently applied" in this example?

In short, although the "consistency" principle is an extremely important one in federal cost accounting, and although it clearly has its place in distinguishing good from bad supplemental and variable compensation arrangements, it unfortunately too often is just a mantra that is used to justify a result that is otherwise difficult to understand on any policy or accounting ground. In the absence of the necessary clarity on how the "consistency" principle should be applied, a grantee considering something like a Type C arrangement should, to be conservative, structure the supplement so that it is available to non-research faculty as well as research

faculty. It may be that in practice most of those who earn the supplement are research faculty, because their ability to bring in research dollars is of real economic value to the university, and non-research faculty may have difficulty identifying similarly concrete contributions. Grant dollars, however, should not be the predominant factor in setting salaries. As will be discussed in the context of the Type E arrangement below, research supplements that are based "solely on the basis of federal grant-getting prowess" (NIH's words), likely will be more difficult to defend than supplements or differentials that are based on a more nuanced conception of the value contributed by the faculty member through his or her research efforts.

Even if these conservative steps are taken, it is still possible that a federal auditor will attempt to disallow the supplements not on the ground of inconsistency, but on the simple ground that they are set in advance but not guaranteed. It is hard to imagine a good grant policy basis for such a position, and there is no express authority for it in federal grant rules. Given the wording of some of the government's pronouncements in this area, however, a disallowance based on the lack of a guarantee is not out of the question.

D. Type D: Salary increase to market level made possible by new research funding.

Example: Faculty member D's salary is \$80,000. A competitive, market-based, merit-based salary for D would be \$96,000, but the university lacks funds to compensate D and other faculty at competitive market levels.

A new federal award containing two months of salary support allows the university to increase D's salary to the market level of \$96,000.

D spends 50 percent of her total university effort on the new award, and the award is charged \$4,000/month for D's salary (\$96,000 times 50 percent divided by 12).

The government likely would contend that the award can be charged only at \$3,333/month (\$80,000 times 50 percent divided by 12) even though the new salary of \$96,000 is at the competitive market level and therefore presumably reasonable.

Discussion: As discussed above in Section 2.h(1), the government is unlikely to allow an exception to its anti-augmentation policy solely on the ground that the post-augmentation salary is reasonable in relation to the competitive market. If the government were to seek damages for the difference between the allowable charge of \$3,333 per month and the actual charge of \$4,000 per month, the grantee might be in a position to argue that the government suffered no damages because the augmented salary was reasonable. It should be observed, however, that in the circumstances illustrated by the example, it is likely that only the salaries of those faculty with external grant support would be increased to competitive market levels. For faculty without grant support, there would be no source of funding for salary increases. The government therefore could be expected to argue, and with some justification, that the Type D arrangement does not represent a compensation arrangement "consistently applied regardless of source of funds."

E. Type E: Annual salary adjustments taking into account research productivity.

Example: Faculty member E's salary is set in accordance with the university's established faculty compen-

sation policies, which provide for an annual review of compensation based on a review of the quality of achievement and productivity of each faculty member. The annual review process takes into account the competitive market for faculty member salaries, by comparing current and proposed salaries to published benchmarks of salaries of faculty in the same discipline and with similar experience. All applicable aspects of each faculty member's university activity are considered—teaching, research, clinical, administrative, and other university service. For researchers, considerable weight is given to research productivity, which is measured in various ways—by total dollar value of grants received as principal investigator, by personal salary support, by the number of researchers supported, and by the number of research articles published. The quality of research performance also is given considerable weight, based on more subjective considerations. Similar merit-based considerations are applied to non-research faculty.

In general, researchers with very high volume of research and clinicians with high billings tend to have higher compensation than other faculty, but there is no set formula for setting salaries based on research volume or clinical billing, and the differences in salaries between highly-compensated and less highly-compensated faculty are less than the differences in their revenue generation.

Faculty member E is a principal investigator on many NIH research awards and is a highly regarded and widely-published researcher. His annual salary of \$300,000 reflects his success as a researcher. This salary is not subject to reduction during the salary year because of a decline in E's external funding or any other factor, but it may be decreased or increased at the next annual salary review.

Discussion: It is clear that faculty member E's base salary has been "augmented" as a result of the receipt of external funding, in the sense that the salary is higher than it would have been if the level of his external funding had been materially less. Yet it is very unlikely that the government would challenge E's salary based on the facts given above. The salary is set in advance, is guaranteed for the year, and is based on a balanced consideration of research achievement and other factors, consistently applied regardless of the source of support. NIH made it clear in the 2005 AAMC conference call that salary adjustments based on research factors are permissible in the context of an annual salary review.

Institutions can adjust compensation based on past performance and current responsibilities if the adjustment is done on a consistent basis, regardless of the source of support. *Therefore, the faculty member's IBS [Institutional Base Salary] can be reevaluated the next time these levels are set by the institution.* (Emphasis added)

It should be noted, however, that the government might have a different view of E's salary if a substantial part of it were set on the basis of a mechanical formula tied to "federal grant-getting prowess" alone. The government also might scrutinize E's salary more carefully if it appeared that those who received federal grant support had salary levels that were disproportionately high relative to other faculty, or if the university's compensation policy revealed that disproportionate weight was

given to faculty members' research volume, compared to other aspects of productivity or merit. In short, although research productivity certainly may be considered in an annual merit-based salary review, care still must be taken to ensure that the review process does not weight "grant-getting prowess" disproportionately.

F. Type F: Adjustment of paid salary but not base salary.

Example: Faculty member F has a base salary of \$80,000. The university receives a new federal award to which F will devote 25 percent of her total university effort. The grant proposal requests \$20,000 a year in salary support for F. The university uses this additional salary support to increase F's compensation to \$100,000, but continues to use the original base salary of \$80,000 as the basis for charging federal awards.

Discussion: As stated above in Section 2.h(5), the federal policy against research supplements restricts only the salary that may be charged to federal awards. Thus, in the example above, the anti-augmentation policy does not prohibit the university from using all or part of the additional \$20,000 in salary support to augment the faculty member's total compensation. However, the salary rate used to charge the new federal award and other federal awards may not exceed the original \$80,000 base salary.

4: Conclusion

The allowability of supplemental or variable compensation as a charge to federal awards is a complex subject, made more complex and uncertain by differences in wording among federal policies and by informal interpretations or rules of thumb, sometimes unsupported

by published authority, that often are repeated by both government and grantee personnel. The rationale for the government's anti-augmentation policy never has been officially expressed and is not well understood, and the policy sometimes is implemented in a way that seems inconsistent with its stated purpose. In fact, the application of the anti-augmentation policy to some salary arrangements seems contrary to the government's own research interests, as well as those of research institutions. That is particularly so in the case of variable salary arrangements involving the loss and later restoration of base salary as a result of temporary fluctuations in external support during a salary year.

There are a few ways in which grantees may recognize and respond to variability in external research funding without running afoul of the federal anti-augmentation policy. Generally speaking, grantees may recognize research productivity in annual or other periodic compensation reviews, in accordance with consistently applied internal policies. A grantee also may supplement a researcher's compensation with funds obtained from a new grant award, provided that the augmented salary is not then used as a basis for charging federal awards. Compensation may vary with changes in FTE status, and by analogy, there also may be some latitude for decreasing and later restoring compensation in response to a loss and later gain of external funding where the changes in compensation correspond to documented changes in a researcher's appointment status. All of these supplemental and variable compensation arrangements, however, should be used with great care and with a sensitivity to the concerns that appear to underlie the government's policies regarding such arrangements.

augmentation policy based on reasonableness alone.

The second possible response, which may or may not be available depending on the facts, is that the reduced compensation arrangement is tied to a reduced appointment or an appointment with reduced responsibilities. That characterization of the arrangement may be factually accurate at some institutions and not at others, and each instance must be assessed on its own facts and circumstances. In general, however, where a faculty member's compensation has been unilaterally reduced as a result of a reduction in an important activity (in B's case, the loss of a sponsored project), it would be natural for both the faculty member and the university to associate that reduction with a proportionate reduction in the faculty member's obligations to the university. That may be expressed in a variety of ways—as a reduced appointment, a reduction in appointment responsibilities, a reduced scope of activity—the exact words are less important than the concept. Where such an appointment adjustment results in a temporary compensation reduction, and the later receipt of grant support allows the university to restore a faculty member to a full appointment and full base salary, there is no apparent reason to deny the restoration of salary based on the anti-augmentation policy. Because in these circumstances the restoration of compensation results not merely from the receipt of new outside funding but from a change in appointment scope or status, the restoration is analogous to the receipt of summer salary based on extra summer work, or movement from a part-time to full-time status.

A grantee seeking to justify a restoration of compensation on the ground that it resulted from an appointment adjustment would have to be prepared to demonstrate that a true appointment adjustment actually occurred. A faculty member's appointment status is traditionally established through an appointment letter or some similar document, signed by a department chair, dean, or other university official with authority to authorize appointments. Ideally, the reduction and restoration of compensation in a reduced compensation situation would be supported by documentation of corresponding changes in the faculty member's appointment or appointment responsibilities. That is not to say that such documentation would have to take the form of an actual appointment letter, or any other particular form. In order to support the reduction and restoration of compensation, however, it would be important to have documentation that identifies each iteration of the faculty member's appointment in an objective manner, perhaps with estimated percentages of effort devoted to each appointment activity. The documentation should also be authorized by an appropriate university official with authority to adjust faculty appointments—not, for example, by a departmental clerical employee. There are many different ways that such documentation could be prepared, but whatever its form, it should be clear enough to satisfy an auditor that variations in compensation resulted from objective changes in appointment

status and not merely from shifts in available funding.

It is important to emphasize that the "variable appointment" concept described above is not expressly authorized by federal policy, and has not been tested in a federal audit or other review of university compensation charged to federal awards. Even if an institution is able to demonstrate that fluctuations in compensation resulting from such an arrangement are tied to objectively verifiable changes in university appointment responsibilities, it is quite possible that some government auditors or sponsors would object to the arrangement as a form of impermissible salary augmentation. The "variable appointment" concept does, however, offer a possible ground for defending reduced compensation arrangements where appointments have in fact been adjusted and the adjustments have been appropriately documented. Moreover, it does so in a way that ensures that chargeable compensation will never exceed the market-based regular compensation established under institutional compensation policies.

C. Type C: Salary set in advance, with a variable component based on research support.

Example: Faculty member C's salary is in two parts: (a) a "university base" of \$80,000 and (b) a "research supplement" of \$16,000. Both the university base and the research supplement are set in advance as part of the university's annual salary review process. The university base component is fixed for the year; the research supplement is also set for the year, although it is contingent on continuing salary support from sponsored projects during the year. The research supplement may be decreased midyear, but it cannot be increased beyond \$16,000 regardless of how much research faculty member C performs.

The total salary of \$96,000 is consistent with C's qualifications, experience, and productivity. It is also consistent with the compensation of other faculty in his discipline who have similar credentials.

The government might contend that the \$16,000 is an unallowable research supplement because, although it is "set in advance," it is not guaranteed for the salary year. Even if the \$16,000 is considered allowable, if grant support is lost midyear and the supplement is reduced accordingly, the government might contend that a midyear restoration of any of the reduced supplement based on the receipt of a new federal award is unallowable salary augmentation.

Discussion: This example does not involve salary augmentation in the classic sense, because the arrangement described does not result in an increase in compensation based on the receipt of new grant funding. There is a research supplement component to faculty member C's compensation, but that component is set in advance and may not increase midyear as a result of the receipt of new grant funding.

As discussed above in Section 2.f, there is no express authority for the often-stated proposition that, to be allowable as a charge to federal awards, a salary component must be fixed, committed, or guaranteed. The summary of the 2005 AAMC-sponsored conference call with NIH does contain the following statement, which relates to a somewhat different kind of arrangement than the Type C arrangement described above:

[T]he A component, which may be called "base salary," is includible in the calculation of IBS. The B