



UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-4000



PERSONNEL AND
READINESS

SEP 28 2007

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARIES OF DEFENSE
ASSISTANT SECRETARIES OF DEFENSE
GENERAL COUNSEL OF THE DEPARTMENT OF
DEFENSE
DIRECTOR, OPERATIONAL TEST AND EVALUATION
INSPECTOR GENERAL OF THE DEPARTMENT OF
DEFENSE
ASSISTANTS TO THE SECRETARY OF DEFENSE
DIRECTOR, ADMINISTRATION AND MANAGEMENT
DIRECTOR, PROGRAM ANALYSIS AND EVALUATION
DIRECTOR, NET ASSESSMENT
DIRECTOR, FORCE TRANSFORMATION
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DEFENSE FIELD ACTIVITIES

Subject: Executive and Senior Level Pay and Performance Management System --
Close Out Guidance for the 2006- 2007 Performance Appraisal Period

This memorandum marks the close-out of our third full year under a pay-for-performance management system for Executives and Senior Leaders. It also reiterates key elements of our performance management system and provides business rules covering the 2006/2007 performance appraisal period.

The draft Subchapter 920, "Executive and Senior Professional Pay and Performance System," will be followed for the 2006-2007 and 2007-2008 performance cycles. The final regulation will be formally coordinated pending receipt of the Office of Personnel Management (OPM) policy on the Performance Assessment and Accountability Tool and incorporation of the recently adopted Common Tier Structure policies and procedures. A copy of the draft Subchapter 920 may be found at www.cpms.osd.mil/sespm/index.htm.

- Attachment 1 provides a summary of the 2006-2007 policy guidance including changes resulting from the 2006 lessons learned review.
- Attachment 2 provides a timeline for the 2006-2007 performance management summary report and validation.



- Attachment 3 provides the Under Secretary of Defense (Personnel and Readiness) Performance Validation Checklist

An essential part of our system's design is the link of salary increases to performance and accountability, two hallmarks of the President's Management Agenda. Please keep these considerations in mind when evaluating performance this year:

- Supervisors must make meaningful distinctions in performance ratings. Rigorous assessments of executive and senior leader performance will help make these distinctions and support appropriate pay decisions. As with any pay-for-performance system, quotas or forced distributions are not authorized.
- Executive and senior leader pay must be linked to their performance ratings. Basic pay adjustments, bonuses and levels of pay must recognize individual contribution, organizational performance, and /or team performance. The Deputy Secretary of Defense Organizational Assessment must be considered by Rating Officials and Performance Review Board members in the performance evaluation of executives and senior leaders.
- Communicate clearly, candidly, constructively, and fully on expectations and accomplishments. The Department expects senior leaders to devote time and attention to this effort, so clear your schedules and make yourself available.

Under the Department's performance management system, a pay pool concept is used to manage, control, and distribute performance-based pay increases and bonuses. Accordingly, the Deputy Secretary of Defense has approved a 12 percent Pay Pool Factor to adequately reward executives and ensure fiscal responsibility. Any request to exceed a 12 percent Pay Pool Factor must be fully justified and approved by the Deputy Secretary of Defense.

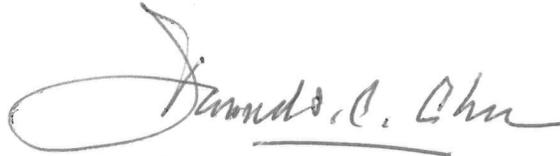
The Deputy Secretary of Defense approved a DoD Tier Structure with common pay ranges and associated business rules to support transparency and comparability in executive position and compensation management. The DoD Tier Structure will become effective on February 18, 2008, for the 2007-2008 performance management cycle. The Department will be developing and coordinating the policy and implementing instructions within the next 30 days.

Further, the Deputy Secretary of Defense approved enterprise-wide, pay setting business rules for the 2006-2007 performance cycle (Attachment 4). These interim business rules will help ease the transition to a common tier structure and help mitigate

unnecessary adverse consequences that may arise with the application of a new Tier Structure on February 18, 2008. These business rules were approved by the Defense Human Resources Board on September 12, 2007. Strict adherence to these interim business rules is required.

As a high performing organization, it is my expectation that each of you will individually and collectively ensure our pay-for-performance system is a great success in terms of planning, developing, monitoring, rating and rewarding the Department's executives and senior level professionals.

I encourage you to visit the SES webpage at www.cpms.osd.mil.sespm/index.htm for resources and guidance. Questions may be directed to Ms. Kay Godette at 703-614-9487 or kay.godette@cpms.osd.mil.

A handwritten signature in black ink, appearing to read "David S. C. Chu". The signature is fluid and cursive, with a large loop at the beginning and a horizontal line at the end.

David S. C. Chu

Attachments:

As stated

Fiscal Year 2007 Executive and Senior Professional Performance Close Out Policy Guidance

Below is a quick summary of the key performance management policy requirements. They are not intended to substitute for the policies in Subchapter 920. Further, they must be understood and applied in the context of Subchapter 920.

Key Performance Rating Business Rules

- Any element rated unsatisfactory (i.e., receives fewer than 51 points) results in an Unsatisfactory Performance Rating
- Second Level Review of Initial Summary Rating is optional
- Higher Level Review of Initial Summary Rating requires an independent review:
 - Executive may respond, in writing, after Initial Summary Rating prior to review by the Performance Review Board
 - Executive must request review within 7 work days of receiving the Initial Summary Rating
 - Reviewer must respond within 7 work days
 - Reviewer makes a recommendation to the executive, Rating Official, Performance Review Board, Pay Pool, and Authorizing Official
 - Authorizing Official decision is final
- An executive may not grieve the Performance Plan, Appraisal, Performance Rating Level, Performance Score, Share Allocation, Adjustment in Basic Pay, non-receipt of a Performance Bonus, or Amount of Bonus.
- Executives who change jobs to a position in the same or different DoD Component with a different Pay Pool after the last day of the appraisal period but before the effective date of the Performance Payout, will be evaluated and assigned an Annual Summary Rating by the Authorizing Official of record on the last day of the performance appraisal period. The executive's payout shall be calculated based on the pay pool funding factor and share value of the gaining pay pool.
- Executives who change jobs to a position outside the Department after the end of the performance rating period, such executives are not entitled to a pay increase but may be considered for a performance bonus. It would not be appropriate to deny a bonus payout solely on the basis that the executive left the organization after the end of the performance period.

- It is inappropriate to deny or reduce a performance payout to PRA winners solely on the basis of receiving one of these awards. The decision to grant a performance payout must be based upon accomplishments during the applicable performance period.

Key Performance Payout Business Rules

- Prorate when less than a full year under the system
- Adjustment to total payout (basic pay and or bonus) based upon documented reasons. Provided some considerations:
 - Recognize team accomplishment (upward increase)
 - Extraordinary accomplishment beyond what the formula calculated (upward increase to either basic pay or bonus)
 - Recent significant in-hire basic pay increase (e.g. last 12-15 months) (downward)
- Must be documented and approved by the authorizing official

Fiscal Year 2007 Executive and Senior Professional Performance Close Out Timeline

Assessing and Evaluating Performance – September 30 - October 31, 2007

- Obtain and consider preliminary performance accomplishments;
- Appraise performance based on individual and organizational performance;
- Extend the performance appraisal period for an executive who has not met the minimum 90-day requirement. The executive's performance appraisal period must be extended for a period no longer than 15 months;
- Appraise performance consistent with Subchapter 920 and Merit Principles (5 U.S.C. 2301);
- Assign a performance score for each Performance Element.
- Conduct an end of year performance review with each executive and senior professional;
- Provide a preliminary performance assessment pending final review and approval by the Authorizing Official;
 - Discuss the overall performance, the tentative Performance Rating, Performance Score, and recommended number of Share; and
- Do not discuss Share values or performance payout information.

Rating Performance – November 1- 30, 2007

- Conduct Pay Pool Manager reviews
- Conduct Performance Review Board assessments
 - Review Pay Pool Manager recommendations
 - Review DoD and Component Organizational Assessments, as applicable in recommending final performance ratings
 - Ensure performance standards are applied, performance ratings are determined, organizational performance and performance pay decisions processes are executed consistently and fairly
- Prepare final performance management reports
- Obtain Authorizing Official final rating decisions
- Obtain Authorizing Official approval of 2006-2007 performance results

Validating Results – December 1 – 14, 2007

- Submit 2006-2007 performance results to USD(P&R) for validation
 - Authorizing Official certifies results and completes Validation Checklist (Attachment 3)
- Record annual summary performance ratings and pay out information in DCPDS and verify the data for accuracy. DCPDS data are used to analyze

performance results, model the effects of pay pool factor percentages, and provide reports to officials within and outside the Department.

- Bonus payments will be made the last pay period in December 2007. Pay Increases will be effective on the first pay period in January 2008.

inform rating decisions.

Additional Discussion Points:

- Compensation strategies
- If applicable, the number of adjustments to performance payouts and the circumstances under which these adjustments were made;
- The number of and basis for each out of cycle performance pay adjustment;
- How results of the 2006-07 appraisal cycle will be briefed to executives
- The number of and basis for increases above Component Tier Structure ceilings

Data Analysis Requirements:

- Provide a chart(s) depicting the distribution of performance ratings overall and by tier range (if applicable) for performance cycles 2004-05, 2005-06, and 2006-07.
- Provide a chart(s) depicting the average basic pay increase and bonus payment overall, by tier and by rating levels for performance cycles 2004-05, 2005-06, and 2006-07
- Provide a chart depicting distribution of shares

Interim Pay Setting Business Rules for the 2006-2007 Performance Cycle

Guiding Principles:

- Empower PSAs to make decisions in the vast majority of cases utilizing guidance provided by the Deputy Secretary of Defense (DSD), who serves as the Authorizing Official.
- The DSD may delegate his authorizing authority as appropriate.
- Recognize that pay is just one of the ways (and perhaps not the most significant) to recognize and motivate SES members. Other factors include leadership roles, awards (including Presidential Rank Awards and DoD honorary awards), and desirable assignments.
- In making pay decisions, senior leadership should be sensitive to the pay scale of civilian personnel in NSPS pay bands and under the General Schedule, such that, to the extent possible, the pay of SES members is higher than that of their subordinates.
- Exceptions to tier pay limits should occur in rare instances, and require the approval of the Authorizing Official.
- No one will have their pay reduced as a result of going from the current system to the tiered system. (See next section).

Transition Rules:

- Changes to Component Tier Structures are not authorized. This includes adjustments to established pay ranges.
- Pay and position tier decisions should take into account the new Common Tier Structure and avoid, to the extent practical and prudent, placing executives above the pay rates of the new Common Tier Structure ceilings and/or in higher tier levels that clearly would not be justified by the application of the new Common Tier characteristics. It is recognized that the performance results of an executive will guide performance payout decisions.
- Current SES members: Pay increases for those who exceed the Common Tier Structure pay ranges will occur only when the maximum rate of pay changes for that tier and will not exceed 50% of the difference between the old pay ceiling and the new pay ceiling. Exceptions to the ceiling plus 50% difference rule may be applied at the discretion of the Authorizing Official, with written justification.
- New Appointees into the SES Systems: The tier ceilings should act as a control point when accessing the appropriate pay rate for new SES members. Authorizing Officials may offer a salary

of 6 - 10% above the appointee's existing pay, but not to exceed EX-III, unless explicitly approved by the Authorizing Official. In addition, pay above EX-III is reserved for new executives who possess superior leadership or other competencies. Pay setting decisions must consider the nature and quality of the individual's experience, qualifications, and accomplishments as they relate to the requirements of the SES position, as well as the individual's current responsibilities.

- Transfers of other Federal SES into the DoD SES Tier System: Pay increases are generally managed through the annual performance cycle. Under rare and unusual circumstances, if the transfer is to a position of substantially greater scope, responsibility and impact, an out-of-cycle pay increase, generally up to 5%, may be approved by the Authorizing Official.

Movement Within A Tier

- Movement within a tier generally does not constitute an automatic increase in pay. Pay increases are managed through the annual performance cycle. Under rare and unusual circumstances, if the reassignment is to a position of substantially greater scope, responsibility and impact, an out-of-cycle pay increase may be approved by the Authorizing Official, generally up to 5%.
- Pay increases for those whose pay exceed the pay ceiling for their assigned tier will only occur when the maximum rate of pay changes for that tier and will not exceed 50% of the difference between the old pay ceiling and the new pay ceiling. Exceptions to the ceiling plus 50% difference rule would be applied at the discretion of the Authorizing Official.

Movement to a Higher Tier

- Reassignments to a higher tier generally result in pay increases of 6 – 10% for which an out-of-cycle pay adjustment is appropriate and authorized in accordance with SC 920.

Adjusting Pay above EX-III

- From below EX-III
 - Pay increase authorized with a performance rating of Level 5
 - Authorizing Official must approve all increases above EX-III

- Currently above EX-III
 - Pay increase authorized with a performance rating of Level 5
 - Authorizing Official may approve a pay increase for executives who earn Level 4 ratings “in limited circumstances, such as for an exceptionally meritorious accomplishment.”

Movement To A Lower Tier

- Reassignments to a lower tier are as follows:
 - At the Discretion of the Authorizing Official or to Meet Organization Needs
 - The executive retains his/her salary
 - Retains protocol status of previous tier
 - Pay increase are determined based on the tier of record
 - At Request of the Executive
 - The executive retains his/her salary
 - Assumes status of new lower tier
 - Generally, performance payout should be paid in bonus until pay is within the tier range. Pay increases for those who exceed the pay range will only occur when the maximum rate of pay changes for that tier and will not exceed 50% of the difference between the old pay ceiling and the new pay ceiling. Exceptions to the ceiling of 50% rule would be applied at the discretion of the Authorizing Official.
 - For Cause
 - Upon receipt of a minimally successful or unsatisfactory annual summary rating, failure to meet a critical performance element, and/or disciplinary circumstance, a decrease in pay will be considered.
 - Reduction may not be greater than 10% of the executive’s basic pay
 - Requires written notice, a reasonable response time and approval by the Authorizing Official
- For Noncareer SES, basic pay increases comply with the guidance and policies that also apply to career executives. (Note: Prior to processing the actions, approval must be obtained from the White House Presidential Personnel Office, as well as the Office of Personnel Management.)

Performance Payout:

- Pay increases for those who exceed the pay range will only occur when the maximum rate of pay changes for that tier and will not exceed 50% of the difference between the old pay ceiling and the new pay ceiling. Exceptions to the ceiling of 50% rule would be applied at the discretion of the Authorizing Official.