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INTERNAL REVENUE SERVICE

IRS Initiatives to Resolve Disputes Over Tax Liabilities

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The Honorable Nancy L. Johnson
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Chairman Johnson:

Each year, thousands of disputes arise between taxpayers and the Internal Revenue Service (IRS) over billions of dollars in additional taxes recommended by auditors in IRS' Examination Division (Examination). IRS eventually resolves most of these disputes over tax liability without litigation through negotiations with taxpayers in its Office of Appeals, but the resolution process can take years and hundreds of staff hours for disputes over large tax amounts because of the complex issues involved.

Since 1990, IRS has made available to certain groups of taxpayers several initiatives to provide alternative ways for resolving certain tax disputes without litigation. We are addressing this report to you at your request because of your ongoing interest in IRS' enforcement programs and IRS' use of performance measures in striving to achieve its mission and program goals. Our objectives were to (1) analyze IRS' design of these initiatives and taxpayers' use of them to resolve disputes between IRS and taxpayers over tax liability, and (2) analyze IRS' plans for evaluating the impacts of its new initiatives on the stated goals.

Background

The federal government and the private sector have long recognized that litigation is costly, time consuming, and destructive of cooperative relationships. Congress intended that federal agencies avoid these problems by offering prompt and inexpensive administrative processes for resolving disputes; yet, over the last 30 years, agency processes have grown more formal, costly, and time consuming.

Seeking to counter this trend, the Administrative Conference of the United States (ACUS) began in 1982 to encourage federal agencies to use alternative dispute resolution (ADR) processes.[1] Because use of ADR grew slowly among federal agencies, Congress passed the Administrative Dispute Resolution Act in 1990 to explicitly authorize and encourage

[1]ACUS was an independent federal agency established in 1964 to promote efficient, adequate, and fair procedures in federal agencies. It was not funded in fiscal year 1995 and passed out of existence.

agencies to use neutral third party ADR techniques (app. I describes these types of ADR techniques).[2]

Well before the 1990 act, IRS offered an administrative dispute resolution process through its Office of Appeals (Appeals) as an alternative to litigation. Otherwise, a taxpayer dissatisfied with the tax adjustments recommended by an IRS auditor can either take the dispute to Tax Court, where IRS' District Counsel initially transfers the dispute to Appeals, or pay the additional taxes and claim a refund in the U.S. Court of Federal Claims or a federal district court.

Organizationally located in the Office of the Commissioner, Appeals operates independently from IRS functions such as the Examination Division, which performs audits to determine the correct tax liability, and the Office of Chief Counsel, which litigates Tax Court cases for IRS. Its mission since 1927 has been to resolve tax controversies without litigation on a basis that is fair and impartial to both the government and the taxpayer and that will enhance voluntary compliance and public confidence in IRS' integrity and efficiency. With a staff of about 2,150 employees, Appeals is one of the oldest and largest dispute resolution organizations in the United States.

Appeals' process consists of an administrative review by an Appeals officer and negotiations with the taxpayer, usually after an IRS audit, over the tax treatment of one or more issues on the tax return. An Appeals officer must first review the relevant facts, law, regulations, and court cases. Then, through written submissions from the taxpayer and one or more informal conferences, the Appeals officer must assess the relative merits of the opposing views and determine an acceptable settlement position for IRS. Unlike Examination, which is limited to applying the tax code, Appeals is authorized to consider the hazards of litigation. Thus, the Appeals officer can negotiate with the taxpayer and make concessions to arrive at a settlement that attempts to approximate the probable results if the case were to be tried in court.

[2]In recent years, Congress has encouraged federal agencies, including IRS, to use ADR techniques instead of litigation or adversarial administrative procedures. The 1990 act serves as an example of this encouragement. This act terminated in October 1995, but Congress reauthorized use of these techniques in an October 1996 act. IRS' initiatives, for the most part, do not involve neutral third parties, and thus do not include the full range of ADR techniques encouraged by the act.

This appeals process handles an average inventory of about 53,500 dispute cases.[3] Appeals' processing time for small cases (those with less than $10 million in dispute) that are not docketed in the courts averages about 8 months.[4] Larger, more complex cases average about 2.4 years to process. While the larger cases comprise about 1 percent of all Appeals cases, they account for about 88 percent of the tax dollars in dispute. Most large cases come from IRS' Coordinated Examination Program (CEP), under which IRS audits the largest corporations. Overall, Appeals has been resolving about 85 percent of its large cases.

In addition to Appeals, which has the major role in dispute resolution, two other IRS functions also have roles in dispute resolution. The Examination Division attempts to resolve disagreements over additional tax recommendations with taxpayers before they go to Appeals. The Office of Chief Counsel also has a role, particularly when Appeals' negotiations do not resolve the disputes. All three functions have developed initiatives to improve the resolution of disputes over tax liability.

Results in Brief

Since 1990, IRS Appeals, Chief Counsel, and Examination[5] have implemented at least eight initiatives to improve dispute resolution between IRS and taxpayers over certain tax issues (app. II describes IRS' initiatives). Each of the initiatives applies to specific groups of taxpayers, generally large corporations. Two of these initiatives seek to prevent disputes, three seek to resolve disputes before they reach Appeals, and two seek to resolve disputes in Appeals more quickly. Only one initiative uses a neutral third person as a mediator to help resolve disputes in Appeals. Generally, the goals of these initiatives are to reduce the overall time, costs, and taxpayer burden of dispute resolution.

In June 1996, IRS identified 276 taxpayers that had used or were using 1 of IRS' 8 initiatives to resolve tax disputes since 1990. As of November 30, 1996, IRS data showed that these taxpayers had used IRS' initiatives to

[3]The average inventory for Appeals cases is based on the fiscal year-end inventory for the 5-year period ending September 30, 1995.

[4]Appeals divides its case workload into two basic categories: nondocketed and docketed. Nondocketed cases are those protested directly to Appeals by the taxpayer; docketed cases are those entered on the calendar, called the docket, of the Tax Court and referred to Appeals by the District Counsel.

[5]Other IRS functions, such as Collection, have undertaken initiatives for resolving disputes other than those involving the amount of income tax to be assessed.

resolve 209 disputes over tax issues.[6] This is a small fraction of the relevant disputed tax issues since 1990. Various reasons exist for the limited use of the initiatives to date. For example, the initiatives were relatively new and generally target disputes with very large corporations for certain types of issues, such as employment taxes. Also, IRS officials said use of the initiatives ultimately depends on the willingness of eligible taxpayers.

IRS has established some performance measures intended to evaluate the impacts of its initiatives on reducing the time, costs, and taxpayer burden in dispute resolution. Our analysis indicated that many of these measures will not allow IRS to directly gauge the initiatives' impacts on these goals. For example, Chief Counsel and Examination both have as a measure the number of times the initiatives were used. Officials from these functions believe that frequency of use means a reduction in time, costs, and burden. But knowing how often initiatives were used does not answer the question of how effectively they reduced time, costs, and burden. Appeals has established some measures, such as the level of taxpayer satisfaction, that are more directly related to its initiatives' goals of reducing the time, costs, and burden of dispute resolution.

IRS officials said they thought it was too early to assess the impacts of all of their initiatives and it was difficult to obtain data that would isolate the impacts, particularly when the issues being resolved are highly technical and can carry over to future tax years. IRS officials described ongoing efforts to develop other measures, in conjunction with a special IRS task force, by the spring of 1998. We recognize the challenges of developing measures and evaluating the initiatives as well as the importance of proper timing of the evaluations. Even so, measures that more directly gauge the impacts of the initiatives on their goals would help IRS determine, after sufficient data are available over a period of time, whether and the extent to which the initiatives had the intended effects of reducing the time, costs, and burden of resolving tax disputes.

Objectives, Scope, and Methodology

Focusing on tax disputes between IRS and taxpayers, our objectives were to (1) analyze IRS' design of its initiatives and taxpayers' use of them since 1990 in resolving disputes over tax liability, and (2) analyze IRS' plans for evaluating the impacts of its new initiatives on their goals. To gain perspective in doing work on both objectives, we first reviewed the 1990

[6]This figure does not reflect the unknown number of disputes over transfer pricing issues that were avoided by using one of the initiatives that focuses on those issues.

and 1996 acts, the Congressional Record, and various ACUS publications including its 1995 report to Congress.

To address both objectives, we first asked IRS officials to identify initiatives begun since 1990 to help resolve tax disputes between IRS and taxpayers. They identified 11 initiatives, of which our review included 8. Tax Court Rule 124 was excluded because it is under the jurisdiction of the United States Tax Court. IRS' Ombudsman was excluded because it has existed since 1988 and its scope of disputes goes beyond issues of tax liability. Simultaneous referral to Appeals/Competent Authority was excluded because its stated purpose was to enhance the competent authority process. According to the Assistant Commissioner (International), the competent authority process addresses disputes between the United States and treaty nations rather than disputes between the IRS and taxpayers. Appendix II briefly describes these additional IRS initiatives.

To analyze IRS' design of its dispute resolution initiatives since 1990, we first learned about IRS' traditional dispute resolution method—the appeals process—and the roles that the Examination and Chief Counsel had in the dispute process. To do so, we reviewed published procedures and reports, and interviewed officials in these functions at IRS' National Office. To learn about IRS' new initiatives, we reviewed related authorizations and procedures as well as written comments on proposed initiatives from inside and outside of IRS. We interviewed IRS National Office officials in the Examination Division, Office of Appeals, Office of Associate Chief Counsel (International), and the Office of the Assistant Commissioner (International).

To analyze taxpayer use of IRS' initiatives, we asked IRS to identify taxpayers that have used an initiative since 1990 by name and identification number so we could develop profiles of those taxpayers. In June 1996, IRS provided that information on 276 taxpayers, usually very large corporations, that had used or were using 1 of the 8 initiatives. Using this information, we queried IRS' Statistics of Income (SOI) database on corporate filers for 1993—the most recent data available. Being a sample of all taxpayers, this database had profile information on 209 of the 276 taxpayers. We then identified the number of disputed tax issues that were resolved under an initiative for the taxpayers through November 30, 1996. Finally, we interviewed officials at the Tax Executives Institute (TEI) and collected documentation on TEI's views of IRS' initiatives. Because TEI

represents very large corporations—the major users of IRS' initiatives—TEI's views provided insights on the issue of taxpayer usage.

To analyze IRS' strategy for evaluating the impacts of its new initiatives, we reviewed ACUS guidance for evaluating ADR programs and IRS functions' evaluation plans, questionnaires, and reports such as the 1995 Appeals' Measurements and Standards Task Force report. We did not attempt to evaluate the impacts of IRS' initiatives because they generally were too new and IRS data were not readily available.

We requested comments from IRS and TEI on a draft of this report. On March 17, 1997, we obtained comments from representatives of the IRS Commissioner. We received written comments from TEI on April 4, 1997. As appropriate, we made changes in the report based on these comments. The comments and our evaluation of them are discussed starting on page 27. We conducted our review from March through December 1996 at Washington, D. C. and our Kansas City Office in Mission, KS, in accordance with generally accepted government auditing standards.

IRS' Initiatives Target Specific Taxpayers and Issues

IRS has implemented eight initiatives since 1990 to improve resolution of its disputes with taxpayers over certain tax issues. These initiatives attempt to meet goals related to reducing the time, costs, and burden of dispute resolution. IRS' design and timing of these initiatives have, to date, limited taxpayers' use of the initiatives.

IRS' Initiatives to Improve the Resolution of Disputed Income Tax Liability Issues

Since 1927, IRS' Appeals function has offered taxpayers an administrative process to resolve disputes over tax liability. This traditional process, while resolving most tax disputes without litigation, can be time-consuming, costly, and adversarial. In the process, the Appeals officer acts more as an independent reviewer and negotiator on behalf of IRS than as a neutral third party chosen by the disputants to help design their own resolution. As such, Appeals' process is best characterized as settlement negotiations with the taxpayer.[7]

To improve the resolution of tax disputes between IRS and taxpayers, IRS' Appeals, Chief Counsel, and Examination functions have implemented at least eight initiatives since 1990. One of these initiatives—Appeals'

[7]Unlike the 1990 act, the 1996 act did not include a reference to "settlement negotiations" in the list of ADR techniques. The deletion was made to clarify Congress' intent to encourage use of neutral third-party methods. According to ACUS, settlement negotiations do not use a neutral third party, and do not constitute an "alternative" resolution method because agencies already had been using them.

mediation initiative—uses neutral parties to help resolve disputes. Two initiatives seek to prevent disputes, three seek to resolve disputes before they reach Appeals, and two seek to resolve Appeals cases more quickly. Generally, the goals of these initiatives are to reduce the overall time, costs, and taxpayer burden of resolving disputes without litigation. The following summarizes the initiatives across the three functions (see app. II for a fuller description).

- Using Neutral Third Parties: In fiscal year 1996, Appeals completed a 1-year test of mediation procedures for nondocketed CEP cases.[8] Mediation has been designed to be an additional attempt to avoid litigation and to be available only after negotiations in Appeals are unsuccessful. Once IRS approves a request for mediation, Appeals and the taxpayer are to select a neutral third party from inside or outside IRS as mediator and to enter into a written agreement on the issues to be discussed and the location and dates of the mediation.
- Preventing Disputes: In 1991, the Office of Chief Counsel (International) implemented its Advance Pricing Agreements (APA) Program to avoid disputes over intercompany transfer pricing issues. Transfer pricing refers to the amounts that affiliated members of a multinational corporation charge one another for goods and services. IRS developed the APA program to avoid transfer pricing disputes and the prolonged, expensive litigation that had been used to resolve the disputes. Under an APA, IRS avoids such disputes by reaching a prospective agreement with the taxpayer on an appropriate transfer pricing methodology, the factual nature of the transactions involved, and the expected results of the methodology.

  In 1996, Appeals began to offer taxpayers the option of receiving IRS valuations of art works for such purposes as estate and gift taxes and the charitable contribution deduction on an income tax return. These procedures permit a taxpayer to have an art valuation for tax purposes approved prior to filing the tax return, thus avoiding any dispute during an audit.[9]

- Resolving Disputes Prior to Appeals: In 1994, Examination implemented the use of closing agreements between IRS and the taxpayer that were designed to extend the current resolution of a particular issue during a CEP audit to future audits of tax years ending prior to the date of the

[8]IRS has extended the test period for another year beginning on January 13, 1997.

[9]IRS has used a panel of outside experts since 1968 to evaluate appraisals submitted by taxpayers to support the fair market value claimed on federal income, estate, and gift tax returns for works of art. Disputes over the value of the art can affect tax liability.

agreement. IRS called this Accelerated Issue Resolution (AIR). It avoids raising the same issue when those tax years are audited. IRS audits nearly all tax returns filed by CEP taxpayers.

In 1990, IRS gave limited authority to CEP case managers to accept settlement offers on issues that "recur" or "rollover" across the tax years being audited by applying a previous Appeals settlement with the same taxpayer and issue.[10] In 1996, IRS gave limited settlement authority to CEP case managers for particular issues in designated industries. These issues involve those for which (1) IRS' position needs to be coordinated across its functions to promote consistent, nationwide treatment, and (2) Appeals has published issue papers containing settlement guidelines.

- Resolving Disputes in Appeals: In 1994, Appeals started accepting the early referral of key disputed issues before the end of a CEP audit in the hopes that concurrent processing would reduce total processing times and that early resolution of a key issue would help resolve related issues in Examination. In 1996, Appeals started a similar initiative for employment tax audit disputes.

To Date, Use of Initiatives Is Limited

As of November 30, 1996, IRS records showed that CEP and large corporate taxpayers had used 7 of IRS' initiatives to resolve at least 209 tax issues in dispute between IRS and taxpayers since 1990.[11] Compared to the tens of thousands of disputes we estimate are raised annually by the audits of these taxpayers, the number of resolutions achieved by IRS initiatives is small.[12]

Several reasons, including IRS' design and timing of the initiatives, help account for the limited use. First, IRS generally limited use of its initiatives

[10]A "rollover" issue arises from a taxable event that impacts more than one tax period. A "recurring" issue arises from separate or repeated taxable events for which a taxpayer advances the same legal position. In 1996, IRS revised this limited authority to include any CEP audit issue for which Appeals had previously settled the same issue of the same taxpayer or of another taxpayer who was directly involved in the transaction or taxable event.

[11]The 209 do not reflect the unknown number of disputes avoided through APAs; as of November 30, 1996, IRS had completed 74 APAs. Appeals and Chief Counsel provided updated figures on the number of disputed issues resolved using many of their initiatives as of February 28, 1997. They identified 18 more issues resolved by early referral and early referral for employment tax issues and 82 issued APAs.

[12]IRS does not yet track the total number of disputed issues raised by its audits. Using IRS' data, we conservatively estimate that CEP and other large corporation audits annually generate tens of thousands of disputes. IRS audits about 10,000 to 12,000 large corporations per year, of which about 70 to 80 percent raise one or more tax issues; in 1996, CEP audits raised an average of 17 issues. And, large corporations dispute many audit issues, often those involving large tax amounts.

to CEP taxpayers to date. Although CEP and other taxpayers with large disputes account for about 88 percent of the dollars in dispute, they account for about only 1 percent of Appeals cases. Second, many of the initiatives began recently; three did not start until 1996. Third, IRS intended many of these initiatives to initially have limited applications, as illustrated below.

- Mediation may be requested only when the case is not designated by IRS for litigation, is not docketed before the United States Tax Court, or does not involve certain tax issues, and only after negotiations in Appeals have failed to resolve the dispute.[13]
- Early referral may be used only when the referred issue (1) is not designated by IRS for litigation; and (2) could be expected, if resolved early, to help resolve related issues in Examination.
- Certain initiatives covered unique tax issues; for instance, the APA program dealt only with transfer pricing issues, art valuation dealt only with art, and one early referral initiative dealt only with employment tax issues.
- Limited settlement authority targeted issues that recur in CEP audits.

In acknowledging the limitation on eligibility, IRS officials also pointed out that the eligible population usually disputes very large tax adjustments that take a lot of time to resolve. If the initiatives work, they could reduce the time to resolve disputes, as well as related costs and burdens. We agree that the potential for such reductions exists. Even if IRS finds that the initiatives produce such reductions for some large dollar disputes, other taxpayers, disputing thousands of issues annually, would be unlikely to benefit from these reductions if they continue to not use the initiatives or to be ineligible. IRS officials said they plan to expand the pool of eligible taxpayers and encourage more usage by changing criteria such as user fees for an APA.

IRS officials also noted that eligible taxpayers have the final say on whether to use the initiatives. Some taxpayers may be reluctant to use them because they are comfortable with the traditional Appeals process. TEI officials said their members generally are confident of Appeals' independence and ability to reach fair and practical resolutions; a 1993 TEI survey indicated that over 80 percent of the respondents were satisfied with the Appeals process. As discussed in our 1994 CEP report, IRS litigated relatively few CEP tax disputes and only assessed 22 percent of the taxes

[13]About 69 percent of Appeals cases are nondocketed. The certain issues include those that involve (1) specialized industries, (2) coordination across IRS to ensure consistent treatment in the audit or appeals process, and (3) tax treaties with other nations.

recommended in CEP audits after Appeals' settlement process.[14] TEI officials also said CEP corporations may not yet be comfortable using mediation because it is relatively new and IRS has rejected five of nine requests that did not meet IRS' eligibility guidelines for mediation.[15] TEI suggested that IRS mediation guidelines, while necessary, should not be too restrictive and that IRS should better promote the use of its initiatives.

As for those that have used or were using the initiatives, we analyzed the most recent IRS information about the types of users. As of June 1996, we found information on 209 corporations that had elected to use an IRS dispute resolution initiative since 1990.[16] Appendix III contains tables that profile users by type of initiative and the category of industry as well as the average amounts that the users reported on their corporate income tax return for total assets, total income, taxable income, and income tax.

For example, 50 percent of the 209 corporations were manufacturers. Another 23 percent were involved in the financial, insurance, or real estate industries, with banks being the most common users in this category. Further, the average amounts of total assets, total and taxable incomes, and net tax liability by type of dispute resolution initiative varied widely but were relatively large because nearly all users were CEP taxpayers. To illustrate, average total assets ranged from about $7 billion to about $57 billion, and average taxable income ranged from about $207 million to about $1 billion by type of initiative.

IRS' Selected Performance Indicators Will Not Measure the Impacts of Initiatives on All Goals

IRS' goals for its initiatives include reducing the time and costs consumed by dispute resolutions and improving taxpayers' satisfaction with the process. The goals also address improvements to the outcomes of the resolution process, including voluntary compliance with the tax laws. IRS officials also told us that an overarching goal of the initiatives is to resolve more disputes without litigation.[17] However, IRS' current performance indicators (or measures) are not designed to directly gauge the impacts of the initiatives on all of these stated goals, particularly the time and costs.

[14]Tax Administration: Compliance Measures and Audits of Large Corporations Need Improvement (GAO/GGD-94-70, Sept. 1994).

[15]Two requests did not involve CEP cases, two were premature, and one involved docketed years not under Appeals' jurisdiction. Of the four approved requests, two have been completed as of November 1996.

[16]Taxpayers involved in the 209 resolved disputes were not the same 209 taxpayers that IRS identified as having used 1 of the 8 initiatives, including APAs, and that we found in IRS' SOI sample; it is coincidence that both populations total 209.

[17]IRS officials also told us that litigation is necessary at times to ultimately resolve disputes over selected tax issues.

ACUS has provided guidance on possible ADR program goals and performance measures (app. IV summarizes ACUS' guidance on evaluating ADR). The goals include (1) reducing the time and costs consumed by dispute resolutions; (2) improving the outcomes of the resolution process, such as reducing the dispute inventory or improving the rate at which disputes are resolved; and (3) improving participants' satisfaction with the process and outcomes. To determine whether an ADR program is meeting its goals, ACUS guidance advises ADR managers to collect and compare data for performance measures under conditions with and without ADR.

In addition, the 1993 Government Performance and Results Act provides guidance on the need to have program performance measures that allow an agency to demonstrate a program's effectiveness in achieving its goals. Performance measures that effectively identify whether a program is achieving its stated goals either (1) directly measure change (e.g., amount of time required to resolve disputes with and without the initiative), (2) use a reasonable proxy for the goal (e.g., taxpayer satisfaction with the initiative as an indicator of reduced burden), or (3) provide the data needed to evaluate specific research questions about the program and its effectiveness.

Table 1 presents the goals and performance measures identified for the various IRS initiatives.

Table 1: IRS' Evaluation Measures for the Goals of the Initiatives by IRS Function

Function	Initiative(s)	Goal(s)	Measure(s)
Associate Chief Counsel (Intl), Office of Chief Counsel	Advance pricing agreements program	Improve voluntary compliance with international tax laws and treaty provisions	Number of advance pricing agreements
		Reduce the (1) time and costs used to develop and resolve transfer pricing issues, and (2) rate of increase in resources used on transfer pricing issues	A comparison of average lapse time and staff days to complete an advanced pricing agreement and to complete an audit involving transfer pricing issues[a]
Examination	Limited settlement authority; accelerated issue resolution closing agreements	Improve rate at which CEP taxpayers fully or partially agree with audit issues in Examination	Number of times initiatives are used
		Reduce average calendar days for CEP audits	
		Improve currency of CEP audits	
		Improve voluntary compliance[b]	
		Reduce taxpayer burden	
Appeals	Early referrals	Reduce processing time in Examination and Appeals	Whether Examination case managers and taxpayers perceive that early referral reduced audit hours and calendar days in Examination[c]
		Improve the CEP agreement rate in Examination	Whether Appeals resolved the referred issues and Examination resolved related issues
		Improve taxpayer satisfaction	Level of taxpayer satisfaction
	Mediation	Improve Appeals' rate for settling CEP disputes; resolve nondocketed issues	Rate at which CEP disputes are settled by Team Chiefs in Appeals
		Reduce the costs of litigations	No measure selected[d]
		Improve voluntary compliance[b]	No measure selected
		Improve taxpayer satisfaction	Level of taxpayer satisfaction
	General	Reduce taxpayer burden	Number of taxpayers using APAs /Appeals' initiatives

(Table notes on next page)

[a]This is an interim measure. In addition, Appeals, which is a participant in Counsel's negotiation of an advance pricing agreement, will ask Appeals participants whether the agreement reduced the time needed to resolve issues from open tax years prior to the agreement.

[b]According to the Director, Office of Dispute Resolution and Specialty Programs, improved voluntary compliance is an indirect goal of Examination's and Appeals' initiatives. He said that the initiatives have a relationship to voluntary compliance in that the taxpayers can choose to use an initiative to help resolve disputes. However, IRS has not identified a measure for voluntary compliance.

[c]Although not a selected measure of whether early referral reduced Appeals' case/lapse time, Appeals is also asking appeals officers for the number of hours used to resolve the early referral issue.

[d]Although Appeals has not selected a measure, Appeals officials believe that a successful mediation avoids the costs of litigation.

Source: IRS data.

As table 1 indicates, some of the measures selected by the three functions do not directly gauge the impacts of the initiatives on their stated goals. For example, both Chief Counsel and Examination plan to measure how often a taxpayer uses an initiative. While this is useful information, in isolation it does not demonstrate or measure the effectiveness of the initiatives in reducing dispute resolution time, costs, or taxpayer burden. Also, initiatives in all three functions include voluntary tax compliance as a goal but have not included a related direct measure. A prior director of the APA program acknowledged that voluntary compliance is difficult to measure; current IRS officials agreed and characterized taxpayers' use of an initiative as an indicator of their desire to voluntarily comply. Although this may be true, signing any agreement does not necessarily mean full voluntary compliance in the future. Under the APA program, IRS' Revenue Procedure 91-22 requires taxpayers to submit annual reports that IRS can use in monitoring compliance.

Further, one goal of early referral is to reduce total processing time (Examination and Appeals). However, Appeals' evaluation planning documents show that the primary performance measure addresses only Examination's processing time, and only the impact on Examination processing time is reported to the National Director of Appeals. Appeals plans to collect data about the impact on processing time by asking Examination case managers and taxpayers (i.e., qualitative data) rather than collecting and comparing quantitative data. In March 1997, Appeals officials said that they also will be tracking the number of hours that Appeals officers spend on early referral issues and that their evaluations of early referral will consider the effect on Appeals processing time.

Table 1 also shows that Appeals' planned measures go beyond counting the number of disputes resolved and link more directly with the stated goals of its initiatives. For instance, to assess the impact on the goal of improving CEP taxpayers' satisfaction with the examination and appeals processes, Appeals plans to query taxpayers who use early referral or mediation about their satisfaction with these initiatives.

Officials from Chief Counsel and Examination indicated that they have not completed their evaluation design efforts to directly measure the impacts of their initiatives on all their goals for various reasons. For instance, they said (1) data on the time that field personnel spend working on an APA are not always reliable because IRS has not yet devised a method for distinguishing time spent by field personnel on APA negotiations from time spent on pending examinations of the same taxpayer, and (2) Examination tracks the time spent on the entire audit and tracks certain large dollar issues but does not track all issues nor the time spent by issue.

Further, they pointed to the difficulty in evaluating the impacts, partly because issues associated with initiatives such as APAs and AIRs are often highly complex and extend years into the future. As a result, measuring the impacts of an initiative may have to wait years. They also pointed to the difficulty in isolating the impacts of an initiative when goals such as those involving the number of days to complete a CEP audit or the currency of the tax years being audited can be affected by many other factors (e.g., availability of information on an issue).

Even with these concerns about current data and indicators, it remains important for IRS to measure the effectiveness of the initiatives in achieving their goals. Without this information, IRS cannot know whether the initiatives worked as intended (and if so, to what extent they worked), need improvements, or merit being extended to other issues or groups of taxpayers.

In addition, concerns about the time and costs consumed by dispute resolution in IRS make evaluation of each initiative important. For example, an article reporting a 1996 survey of CEP taxpayers, although showing increased satisfaction with aspects of CEP audits, showed continued dissatisfaction with Examination's ability to resolve issues. In the article, the Assistant Commissioner for Examination said the satisfaction level was not as high as IRS had hoped, particularly given the number of efforts to make CEP audits more efficient and less time

consuming. These efforts include Examination's dispute resolution initiatives.

At the time of our work, the three IRS functions had not yet evaluated the impacts of their initiatives using the measures and goals. In general, officials in these functions said the initiatives were too new or used too infrequently to have sufficient data for evaluation. These officials told us in March 1997 that they have made progress in developing more measures and tools to evaluate the impacts of the initiatives on the goals. They said they are working with a special task force that is developing measures across IRS. These officials said they hope to have sufficient measures by the spring of 1998 in order to more fully evaluate the initiatives. Even so, they believe that the initiatives have been helping to resolve issues without litigation and at reduced time, costs, and burden.

For example, Chief Counsel officials discussed interim and planned measures such as (1) the average lapse time and staff days for completing an APA, (2) the impact of the APA on audit cases opened prior to it, (3) the quality of taxpayer information received while developing the APA, (4) the dollars and number of issues agreed/unagreed for cases with transfer pricing issues developed in Examination, (5) taxpayer satisfaction, and (6) the dollars spent on expert witnesses for litigations involving transfer pricing. Examination officials said they plan to develop a survey to collect feedback from their staff and taxpayers and to measure time spent on an initiative.

Conclusions

For almost 70 years, IRS has relied on its Office of Appeals to resolve most disputes over tax liability that arise after audits in Examination without involving Chief Counsel in litigation with the taxpayer. Even so, Appeals' resolution of tax disputes with large corporations can take years and hundreds of staff hours. Because these three IRS functions have a role in the disputes and their resolutions, each function has started initiatives to avoid disputes over tax liability or improve the resolution process. Since 1990, the three functions have started at least eight initiatives, and Congress has encouraged federal agencies, including IRS, to use neutral third parties in resolving disputes to help reduce the time and costs. One of the eight dispute resolution initiatives that IRS has implemented since then uses a neutral third party to aid dispute resolution.

IRS' initiatives generally attempt to reduce the time, costs, and taxpayer burden of the dispute resolution process by avoiding disputes or

improving the existing process. IRS officials believe that their initiatives have partially met these goals. However, IRS functions are not yet able to show whether their initiatives are achieving these goals, partly because many of the performance measures selected by the functions do not directly gauge the impacts of the initiatives on these goals. Some IRS officials have pointed to the difficulties in evaluating whether the initiatives meet their stated goals. They cited problems in collecting reliable data and isolating the impacts for highly complex tax issues that may involve future tax years. These difficulties, while real, do not prevent IRS from developing indicators that more directly measure the impacts of the initiatives on the time, costs, and burden of dispute resolution.

IRS officials stated that a special IRS-wide task force is helping the IRS functions to develop measures and an evaluation program for their initiatives and that they believe that they are making progress. They said they hope to have sufficient measures during the spring of 1998 to more fully evaluate the initiatives' impacts on the stated goals. Such efforts, if successful, would help IRS to determine whether the initiatives worked as intended and how they might be improved or expanded to other tax issues or groups of taxpayers.

Recommendations

We recommend that the IRS Commissioner hold the IRS functions accountable, in conjunction with the special measures task force, for (1) completing the development of performance measures that directly gauge the impacts of the dispute resolution initiatives on their stated goals and (2) setting milestones to measure these impacts. Using these measures, the functions should, after sufficient data are available over a period of time, analyze whether each initiative reduces the time, cost, and taxpayer burden of dispute resolution.

Agency Comments and Our Evaluation

We obtained comments on a draft of this report in a meeting on March 17, 1997, with IRS officials that represented the IRS Commissioner. These officials included the Assistant Commissioner of Examination and the Director of CEP, the National Deputy Director of Appeals and the Director of the Office of Dispute Resolution and Specialty Programs in Appeals, the Director and Deputy Director of the APA Program in the Office of Associate Chief Counsel (International), and representatives from the Office of Associate Chief Counsel (Domestic) and the Office of Legislative Affairs.

We discussed their comments on our findings, conclusions, and recommendations as well as comments on technical aspects of the draft report. We summarize these comments in this section and made technical changes, where appropriate, in the related parts of the report.

First, in discussing the type of IRS initiatives, IRS officials asked us to describe other initiatives that fall outside the scope of our work or that have recently begun. We expanded our objectives, scope, and methodology section to clarify the rationale for focusing on eight initiatives and excluding three others—Tax Court Rule 124, Simultaneous Referral to Appeals and Competent Authority, and IRS Ombudsman. We describe these and other initiatives that have begun recently in appendix II.

Second, in discussing the limited usage of the eight initiatives, IRS officials said IRS plans to expand the pool of eligible taxpayers. These officials also noted that taxpayers ultimately choose whether to use an initiative. If this is true, any efforts to increase usage by expanding the eligibility pool would not address those who are eligible but choose to bypass the initiatives. We added these comments to the text of the report.

Third, IRS officials stated that they have been working to develop more measures to evaluate the impacts of the initiatives on the stated goals. They pointed to the difficulty in developing comprehensive measures and evaluations, given disputed issues that are highly complex, technical, and may need to be tracked for a number of years before sufficient data are available for analysis, particularly for the APA and AIR initiatives. They believe that they have made progress. They pointed to examples of interim measures they have been developing and measures they plan to develop through a special IRS-wide measurement and evaluation task force. They hoped to have sufficient measures by the spring of 1998 to more fully evaluate the initiatives' impacts on the stated goals. They also offered clarification about some existing goals and measures for mediation and early referral. We have incorporated these comments and clarifications in the section of this report dealing with measures and evaluations.

In discussing our conclusions and recommendations, the IRS officials asked us to more specifically account for the difficulty in developing measures and evaluations for the initiatives. They said, for example, these initiatives address very complex issues that often have to be tracked years into the future before enough data becomes available for an evaluation. They also asked us to account for their efforts to further develop the

measures. Accordingly, we have reworded our recommendations to recognize the work of the measurement task force and the time frame needed to develop sufficient measures. We also have revised our conclusions to further recognize the difficulty in developing measures for evaluation.

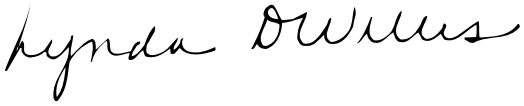
TEI officials generally agreed with our description of the IRS efforts to resolve disputes over tax liability, the appeals mission and process, and the time to complete this process. TEI noted that its members are satisfied with the appeals process and the independence of appeals staff, recognizing that such staff are IRS employees and not neutral third parties. While TEI favors initiatives to resolve disputes without litigation at reduced time and costs, TEI did not want any initiative to detract from the historical role Appeals has played in providing an alternative to costly, time-consuming litigation. Given these views, TEI agreed with our recommendation on performance measures, believing that revising the measures would reflect the importance of dispute resolution techniques and encourage their use.

In addition, TEI stated that it believed the report could provide a stronger endorsement of IRS Appeals and IRS' efforts to develop the initiatives. TEI also believed that IRS should do more to promote use of the initiatives. Given the scope and objectives of our work, we did not take positions on these issues. Although Appeals generally plays a valuable role, we did not design our study to evaluate Appeals; nor did we evaluate how well IRS developed the initiatives and whether the initiatives worked well enough to merit greater usage. TEI also provided technical comments that we have incorporated in the appropriate sections of the report.

We are sending copies of this report to the Subcommittee's Ranking Minority Member, the Chairmen and Ranking Minority Members of the House Committee on Ways and Means and the Senate Committee on Finance, various other congressional committees, the Director of the

Office of Management and Budget, the Secretary of the Treasury, and other interested parties. We also will make the report available to others upon request. Major contributors to this report are listed in appendix V. If you or your staff have any questions on this report, please contact me on (202) 512-9110.

Sincerely yours,



Lynda D. Willis
Director, Tax Policy and Administration Issues

Contents

Abbreviations

ACUS	Administrative Conference of the United States
ADR	alternative dispute resolution
AIR	Accelerated Issue Resolution
APA	Advance Pricing Agreement
CSP	Classification Settlement Program
CEP	Coordinated Examination Program
IRS	Internal Revenue Service
SOI	Statistics of Income
TEI	Tax Executives Institute

What Is Alternative Dispute Resolution?[1]

Alternative dispute resolution, or ADR, is a name for a group of problem-solving methods designed to resolve disputes consensually. These methods usually involve a neutral individual who works with the disputing parties to help them find mutually acceptable solutions. The various ADR methods can be viewed as points along a continuum, ranging from processes over which the parties have the most control (e.g., conciliation, mediation) to processes over which they have the least control (e.g., binding arbitration). Here are some ADR methods:

Conciliation is the attempt by a neutral individual to reduce tensions and improve communications among the parties so they can agree on a process for resolving their dispute.

Facilitation uses a neutral individual to assist the parties in a meeting where the established process is used.

Mediation uses a trained neutral individual to help the parties negotiate a mutually agreeable settlement. The mediator has no independent authority and does not render a decision or opinion; a decision must be reached by the parties themselves.

Fact Finding is often used in technical disputes. It uses a neutral party with subject matter expertise to make findings of fact. This can be useful where disagreements about the need for or meaning of data are impeding resolution, or where the disputed facts are highly technical and would be better resolved by experts. The fact-finder usually prepares a report/advisory opinion based on an informal presentation by each party and independent research.

Early Neutral Evaluation uses a neutral individual with substantive expertise to evaluate the relative merits of each party's case. This process usually involves an informal presentation to the neutral of the salient points of each party's position. The neutral provides a nonbinding opinion that can give the parties a more objective assessment of their positions, thereby increasing the chances that further negotiations will be productive.

The **Settlement Conference** uses a neutral individual, generally a judge other than a presiding judge, to serve as a mediator and neutral evaluator in a case pending before an agency tribunal. The settlement judge may give

[1] Federal Administrative Procedure Sourcebook, Administrative Conference of the United States, 2nd ed. (Washington, D. C.: 1992), pp. 227-229.

an informal advisory opinion. If settlement is not reached, the case continues before the presiding judge.

The **Minitrial** is a structured settlement process in which each side presents a highly abbreviated summary of its case before senior representatives of each party. Following the presentations, the senior representatives seek to negotiate a settlement. A neutral advisor sometimes presides over the proceeding, and can mediate or render an advisory opinion if asked to do so.

The **Summary Jury Trial** is a structured settlement process in which each side has a limited time to present its case before a peer jury. The jury's verdict is advisory and is used to facilitate negotiations.

Arbitration uses a neutral individual to decide disputed issues after hearing evidence and arguments from the parties. The arbitrator's decision may be binding on the parties either through agreement or operation of law, or it may be nonbinding or advisory. Arbitration may be voluntary, or it may be mandatory and the exclusive means available for handling certain disputes.

Partnering is a process used in contracting to avoid or simplify disputes. At the start of a project, participants seek to identify common goals and interests and establish clear lines of communication. The process may involve a joint workshop, managed by a neutral facilitator, to develop a team charter; follow-up meetings; and evaluation processes. A partnering agreement usually includes a commitment by the parties to use ADR to resolve disputes that arise during a project.

IRS Dispute Resolution Initiatives

Table II.1 presents the dispute resolution initiatives begun by IRS since 1990 that were included in our review. The table presents information on when the initiative was begun, a brief description, the limits inherent in or placed on the initiative's use, and the number of times taxpayers have used the initiative as of November 30, 1996. Immediately following table II.1 are brief descriptions of additional IRS initiatives not addressed by this report.

Table II.1: IRS Dispute Resolution Initiatives as of March 1996 to Resolve IRS and Taxpayer Disputes Over Income Tax Liability

Initiating function	Initiative	Year Initiated	Description	Limits	Use as of November 1996
Appeals	Advance valuation of works of art	1996	Permits taxpayers to obtain an IRS review of a taxpayer's valuation of a work of art before filing a return.	Limited to works of art.	2 completed
	Mediation	October 1995	Permits taxpayers and Appeals to negotiate a settlement assisted by neutral individuals who have no authority to impose a decision.	1. CEP cases only after negotiations in Appeals. 2. Not available for issues designated for litigation, docketed cases, or ISP, ACIP, or Competent Authority issues. 3. The mediator(s) are either Appeals employees, in which case IRS pays the mediators' costs, or outside parties, in which case IRS and the taxpayer share the expense.	2 completed 5 requests denied 2 in process
	Early referral	March 1994	Allows taxpayers whose returns are being examined to request the referral of a developed, unagreed issue to Appeals while Examination continues to develop other issues.	1. CEP cases. 2. Does not apply to issues designated for litigation or for which the taxpayer has or intends to seek Competent Authority assistance.	23[a]
	Early referral of employment tax issues	March 1996	Allows taxpayers whose returns are being examined to request the referral of one or more employment tax issues to Appeals.	Limited to employment tax issues.	2[a]

(continued)

Initiating function	Initiative	Year Initiated	Description	Limits	Use as of November 1996
Counsel	Advance pricing agreements	March 1991	Taxpayers can request an agreement on the factual nature of intercompany transfers, a transfer pricing methodology, and an expected range of results from the methodology. Agreement may be applied to prior tax years still in dispute.	1. Limited to transfer pricing issues. 2. $5,000 user fee.	74 agreements in force[a]
Examination	Limited settlement authority	November 1990; Rev. 2, March 1996	Grants discretionary authority to Examination case managers to accept settlement offers where a prior settlement has been negotiated by Appeals for the same issue with the same taxpayer, or of another taxpayer who was directly involved in the taxable event.	1. Limited to CEP. 2. The facts must be substantially similar; Appeals must have settled the subject issue on the merits independent of other issues; and legal authority must be unchanged.	81
	Limited settlement authority for coordinated issues	March 1996	Grants authority to Examination case managers to accept settlement offers with respect to coordinated issues within the Industry and International Field Assistance Specialization Programs on which Appeals has coordinated issue papers containing settlement guidelines or positions.	Applies to issues coordinated under the Industry and International Field Assistance Specialization Programs for which Appeals has settlement guidelines.	2
	Accelerated issue resolution	October 1994	Allows district directors, in coordination with other IRS functions, to execute closing agreements with CEP taxpayers that cover both the tax year under audit and unaudited tax years ending prior to the date of the agreement.	1. Limited to CEP. 2. Not available for issues subject to an APA, issues involving employee plans or exempt organizations or partnership items under Tax Equity & Fiscal Responsibility Act of 1982, issues for which resolution would be contrary to an IRS position, or issues designated for litigation.	97

[a]IRS officials provided updated figures as of February 28, 1997, on the use of some initiatives to resolve disputed issues. They identified 39 disputed issues resolved by early referral and 4 resolved by early referral of employment tax issues. They also said 82 APAs were in force.

Source: IRS.

Other Initiatives to Resolve Tax Liability Disputes and Other Issues

1. Tax Court Rule 124 — In 1990, the Tax Court promulgated Rule 124 allowing voluntary binding arbitration of factual issues under the direction of the Tax Court. Arbitration has not been seriously considered to resolve disputes between taxpayers and the IRS outside of docketed Tax Court status.

2. Although no specific Tax Court mechanism for the use of mediation has been developed, mediation can be used by the parties to resolve a Tax Court case under existing Tax Court authority.

3. IRS Taxpayer Ombudsman/Advocate — The Taxpayer Ombudsman was authorized by Congress in 1988 to issue Taxpayer Assistance Orders to stop certain actions to alleviate a hardship faced by a taxpayer. The Ombudsman was replaced by the Taxpayer Advocate, effective July 30, 1996. The Taxpayer Advocate has broad authority to require action or to stop an action with respect to a taxpayer.

4. Simultaneous Appeals/Competent Authority Procedures — Taxpayers may request competent authority assistance when they believe actions of the United States, a treaty country, or both, will result in taxation that is contrary to treaty provisions. If the request is accepted, the U.S. Competent Authority generally will consult with the appropriate foreign competent authority in an attempt to reach an agreement that is acceptable to all parties. According to the Assistant Commissioner (International), the competent authority process addresses intergovernmental disputes between the United States and treaty nations rather than disputes between the IRS and taxpayers and does not meet the definition of ADR.

Revenue Procedure 96-13 established a new competent authority procedure whereby taxpayers may seek simultaneous competent authority assistance and Appeals consideration of the competent authority issue. This procedure coordinates the two processes and is intended to reduce the time required to resolve disputes by allowing taxpayers more proactive involvement. Taxpayers may request simultaneous Appeals/competent authority procedures in four situations: after Examination has proposed an adjustment, after the taxpayer files a protest against the adjustment, after the dispute goes to Appeals, and after a competent authority request has been made.

5. Environmental Cleanup Costs — IRS is developing a revenue procedure that will provide special procedures for requesting written guidance on the

tax treatment of environmental cleanup costs incurred over several years. The procedures will attempt to facilitate resolution of issues involving the capitalization or deduction of such cleanup costs for prior and future years of a single environmental cleanup transaction.

6. Classification Settlement Program (CSP) — The Commissioner announced the CSP on March 5, 1996, to help resolve audit disputes over the classification of workers as either employees or independent contractors. Under the CSP, IRS auditors will offer pro forma settlements to taxpayers under audit using a standard closing agreement developed in the National Office.

Profile Data on Taxpayers That Have Used IRS Dispute Resolution Initiatives

Based on identifying information provided by IRS, we located 1993 SOI data for 209 corporations that have used 1 of 6 IRS dispute resolution initiatives as of June 24, 1996.[1] Table III.1 indicates that the largest number of users by industry are manufacturers. Within IRS' industry codes, the heaviest users were banks (15 percent) and chemical companies (12 percent).

Table III.1: Percent of 209 Corporations Using IRS Dispute Resolution Initiatives by Type of Initiative and Category of Industry

	IRS dispute resolution initiative				
Industry category	**Limited settlement authority**	**Accelerated issue resolution**	**Early referrals and mediation**	**APA**	**All initiatives**
Construction	0%	0%	5%	1%	1%
Manufacturing	50	53	55	48	50
Transportation and public utilities	13	15	4	1	6
Wholesale trade	10	2	9	19	13
Retail trade	13	6	4	2	5
Finance, insurance, and real estate	13	21	23	26	23
Services	0	2	0	3	2
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: GAO analysis using IRS data.

As shown below, income varied substantially by industry for the 209 corporations. The average income for all corporations was over $3 billion. This is not surprising because mostly very large corporations are given the opportunity to use IRS' dispute resolution initiatives. The table also shows that the average taxable income was $443 million and average income tax paid was $76 million. However, 64 of the corporations (31 percent) had no taxable income and paid no taxes. Another 52 corporations (25 percent) paid no taxes on their net income.

[1]Does not include taxpayers that requested advance valuation of works of art and limited settlement authority for coordinated issues. As of the date of our request, only one or two taxpayers had used these methods.

Table III.2: Assets, Income, and Tax Reported by 209 Corporations Using IRS Dispute Resolution Initiatives

Dollars in millions

IRS initiative	Average total assets	Average total income	Average taxable income	Average income tax	Average net tax
Limited settlement authority	$9,700	$2,100	$247	$86	$77
AIRs	23,200	4,700	704	246	112
Early referrals and mediation	56,700	10,200	1,200	435	186
APAs	6,900	1,700	207	72	38
All corporations	16,200	3,300	443	151	76

Source: GAO analysis using IRS data.

The use of tax credits and net operating losses of corporations using IRS initiatives may explain why many of the corporations paid few taxes. Many of the corporations claimed tax credits. For instance, 116 of 209 (56 percent) of the corporations claimed credits totaling about $17 billion. Most of these corporations either had or were seeking APA agreements.

Table III.3: Tax Credits and Net Operating Loss Deduction Claimed by 209 Corporations Using IRS Dispute Resolution Initiatives

		In millions	
Type of credit	No. of corporations	Total amount claimed	Average amount claimed
Foreign tax credit	84	$14,700	$175
General business credit	85	914	11
Alternative minimum tax credit	31	779	25
Total credits	116	16,600	144
Net operating loss deduction	57	4,200	74

Source: GAO analysis using IRS data.

Table III.4: Tax Credits and Net Operating Loss Deduction Claimed by 30 Corporations Using Limited Settlement Authority

		In millions	
Type of credit	No. of corporations	Total amount claimed	Average amount claimed
Foreign tax credit	13	$215	$17
General business credit	9	47	5
Alternative minimum tax credit	8	82	10
Total credits	30	382	17
Net operating loss deduction	10	148	15

Source: GAO analysis using IRS data.

Table III.5: Tax Credits and Net Operating Loss Deduction Claimed by 47 Corporations Using Accelerated Agreements

		In millions	
Type of credit	No. of corporations	Total amount claimed	Average amount claimed
Foreign tax credit	24	$5,800	$242
General business credit	26	335	12,900
Alternative minimum tax credit	7	302	43
Total credits	35	6,500	186
Net operating loss deduction	16	292	18

Source: GAO analysis using IRS data.

Table III.6: Tax Credits and Net Operating Loss Deduction Claimed by 22 Corporations Using Early Referrals and Mediation

		In millions	
Type of credit	No. of corporations	Total amount claimed	Average amount claimed
Foreign tax credit	13	$5,200	$400
General business credit	12	406	34
Alternative minimum tax credit	6	280	47
Total credits	14	5,900	421
Net operating loss deduction	11	3,100	282

Source: GAO analysis using IRS data.

Table III.7: Tax Credits and Net Operating Loss Deduction Claimed by 110 Corporations Having or Seeking APA Agreements

		In millions	
Type of credit	No. of corporations	Total amount claimed	Average amount claimed
Foreign tax credit	38	$3,500	$92
General business credit	28	126	5
Alternative minimum tax credit	10	116	12
Total credits	45	3,700	82
Net operating loss deduction	20	624	31

Source: GAO analysis using IRS data.

Summary of ACUS Guidance on Program Evaluation[1]

ADR program evaluation is simply a way to determine whether an ADR program is meeting its goals and objectives. ACUS recommended systematic planning for program evaluation at the time an ADR program was set up because this allows agencies to establish data collection mechanisms early in the program.

ACUS guidance outlined three phases to program evaluation: (1) planning; (2) design and implementation; and (3) presentation, dissemination, and use of results. This summary addresses the planning and design/implementation phases.

For the planning phase, ACUS guidance noted four planning steps: (1) determining the evaluation's goals, (2) identifying the audience(s) and their needs, 3) considering issues of timing and expense, and (4) selecting an evaluator.

ACUS guidance stated that the evaluation's goals should be tied closely to the goals of the program being evaluated. Ideally, the agency will have established the ADR program's goals in the program design phase. Although terminology differs, evaluations are commonly characterized as either "program effectiveness" or "program design and administration" evaluations. Program effectiveness evaluations, also known as impact or outcome evaluations, focus on whether a program is meeting its goals and/or having the desired impact. Program design and administration evaluations, also known as process evaluations, examine how well a program is operating.

Usually, a variety of people have an interest in the results of a program evaluation. These audiences may be interested in different issues and seek different types of information. Potential audiences should be identified early and kept in mind in planning the evaluations so that their questions will be addressed. For example, program (such as Appeals) officials and legal staff may be interested in the ADR program's impact on case inventory and the nature of settlements, how long it takes to resolve cases, and whether ADR promotes long-term compliance; budget officers may be interested in whether ADR has achieved cost savings; and members of Congress may be interested in how the use of ADR affects budgets.

Evaluation can be undertaken at different times during the life of an ADR program. Among the factors to consider are whether the program has been

[1] Evaluating ADR Programs: A Handbook for Federal Agencies, Administrative Conference of the United States, Dispute Systems Design Working Group (Washington, D. C.: 1995).

in operation long enough to have sufficient cases available for analysis, and whether the program has resolved early implementation problems. The agency also needs to (1) identify budget and resource constraints, organizational opposition, and operational difficulties; and (2) develop strategies for dealing with them. The agency should also consider the qualifications of objectivity, experience, technical expertise, and understanding the context in which the ADR program operates in selecting the evaluator(s).

For the design and implementation phase, ACUS guidance laid out broad steps for an effective ADR program evaluation. These included

- understanding ADR program design and operation,
- translating evaluation goals into measurable performance indicators,
- determining data needs and availability,
- selecting an appropriate design strategy,
- deciding how to collect the data,
- collecting the data, and
- analyzing and interpreting the data.

Once the evaluation's goals have been established, evaluators can select appropriate performance indicators. Performance indicators represent the questions being asked in the evaluation and serve as the basis for data collection and analysis. According to ACUS, measuring all aspects of an ADR program is neither easy nor necessary. Some types of data are harder to obtain, and some areas of a program are more important than others to examine.

ACUS' evaluation guidance included a list of performance indicators, which it intended as a "sampling" from which agencies could select as they formulated ADR program goals and identified measures of program effectiveness. For program effectiveness evaluations, the list presented indicators under three categories—efficiency, effectiveness, and customer satisfaction.

Indicators of efficiency included measures of cost and time.

Indicators of effectiveness included measures of dispute outcomes, durability of outcomes, and impact on the dispute environment. Suggested measures of dispute outcomes include (1) the number of settlements achieved through ADR; (2) the number of cases going beyond ADR to litigation; (3) the nature of monetary and other outcomes; and (4) the

relationship between outcomes and other factors, such as complexity, number of issues, or number of disputants. Suggested measures of durability included (1) rate of compliance with negotiated agreements, (2) rate of dispute recurrence, and (3) impact on organizational environment. Suggested measures of impact on dispute environment included (1) size of case inventory, (2) types of disputes, (3) timing or level of dispute resolution, (4) management or public perceptions, and (5) negative impacts.

Indicators of customer satisfaction included measures of participants' satisfaction with the process, impact on relationships, and participants' satisfaction with outcomes. Measures of participants' satisfaction with the process included perceptions of fairness, appropriateness, usefulness, and control.

A variety of research designs are available for use in evaluating ADR programs. Possible design strategies include case studies, time series analysis, and group comparisons. Evaluation planners should consult persons with research methodology expertise when selecting a design strategy.

Once the evaluators determine what to measure, the next consideration is what data to collect. In a program effectiveness evaluation, evaluators need to be able to describe the situation without the ADR program (sometimes referred to as the baseline) to serve as a basis for comparison. Comparison information is not always easy to obtain, especially if the agency does not keep ongoing records reflecting the relevant information. Ideally, evaluators collect comparison data by using a control group. If a control group is not available, alternatives must be used, although they may not provide as good a comparison. For example, comparison data can be collected by looking at the historical period before the ADR program began.

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