Improving the Montana Department of Revenue Income Tax Division service delivery by improving integration.

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Improving the Montana Department of Revenue,
Income Tax Division Service Delivery by
Improving Integration

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CHAPTER I
INTRODUCTION

Statement of the Problem

The State of Montana is in the midst of an economic crisis. The State's major industries, agriculture, timber products and natural resource extraction, are all depressed and there is little the State can do alone to turn the economy around.

One obvious effect of the depressed state of Montana's economy is that State government revenue from income and production-based taxes is below the expectations of past budget and program planners. As a result Governor Schwinden has had to call for reduced agency spending during the current biennium to meet a State commitment to a balanced budget. The State's short term economic future and prospects for significantly greater revenue from the above mentioned sources are also bleak. Various studies suggest that if State government maintains its current service levels and makes no effort to improve the efficiency of service delivery through changes in structure and policy the State could amass a deficit as high as $250 million.

Conversely, there is no evidence to suggest that the demand for State government services has diminished. On the contrary, the demand for services offered by some agencies has increased. The Department of Social and Rehabilitation
Services, for example, was recently challenged and eventually ordered to provide more services than were authorized by the legislature.

The Montana Department of Revenue has been subjected to similar service demands. Despite compliance with the governor's call for reduced spending, the Department's operating divisions are expected to service the State's budget, i.e., identify and collect revenue due the State at levels projected in the 1985 legislative session. The projections made in the 1985 session assumed the availability of all funds appropriated.

The Department's Individual Income Tax Division complied with all requests for reduced spending. Full time employee positions have been left vacant for extended periods of time or eliminated altogether, travel for field agents has been cut back and equipment purchases approved by the legislature have not been made. The Division's enforcement sections, however, are still expected to identify and collect revenue due the State at levels projected in the 1985 legislative session. Put simply, the Division is expected to do as much or more with fewer resources. To meet these situational demands the Division requested an analysis of its structure and policy to locate opportunities for maintaining or improving Division service delivery. In response to the Division's request, this paper constitutes an evaluation of the Income Tax Division's structure and policy in terms of
how to improve interdivisional and intradivisional integration. Recommendations are made to achieve more effective integration, enabling the Division to maintain or improve service delivery with fewer resources.

**Research Method**

Organization theorists believe effective integration is essential for an organization to be healthy and productive. In the field of systems analysis, effective integration is defined as organizational circumstances in which neither the structure nor the mechanics of the organization hinder division performance nor allow segments of the organization to work to a cross purpose. Arthur Walker and Jay Lorsch in their analysis of the relative merits of organizing by function and by product defined integration as the collaboration of specialists. Both definitions are very broad. I have, therefore, identified more specific criteria with which to evaluate division integration and determine whether or not organizational structure or mechanics hinder division performance or collaboration between specialists.

For the purposes of this analysis the following criteria

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were used to identify integration problems:

1. Efficiency of document transfer.
2. Efficiency of information exchanges.
3. Effective use of existing personnel.
4. Effective use of existing equipment.

I chose to analyze the division in terms of integration because the manner in which the division and its parent organization, the Department of Revenue, are organized and responsibilities delegated necessitate effective integration. While the Income Tax Division is ultimately responsible for the administration of the state’s individual income tax, it does not always control income tax division documents or all of the information pertinent to the administration of the tax that is maintained by the Department as a whole. Other Department divisions will control the documents at certain points in the process, such as the initial receipt of the documents and document data entry into a computer system. Other divisions also maintain income information that, when correlated with income tax division information, helps ensure the proper amount of state income tax is paid.

Intradivisionally, subunits of the division rely on one another for efficient and effective transfers of documents and information as well. Each division subunit performs a fraction of the division’s overall responsibilities. When a division subunit completes its tasks, it must pass on
division documents and information to those subunits responsible for remaining tasks.

The division is organized under an administrator into two bureaus and eight sections. Each of these subunits relies on the others for document transferral, information, and the performance of functions outside their areas of responsibility. An examining bureau section, for example, will rely on administrative services sections to transfer documents to data entry or collection personnel to ensure the data gathered is accurate and taxes due are collected. The managers of the aforementioned sections and bureaus must deal with other division sections and bureaus on a daily basis. They must also deal with the other Department divisions to gather information and receive and transmit documents.

To identify integration problems and associated opportunities to improve division service delivery, I interviewed each of the Income Tax Division’s section supervisors and bureau chiefs. Each was asked five questions:

1. What is your section’s or bureau’s responsibility?

2. Describe the section/bureau work flow: where do documents and information come from; where do documents go upon completion of your task; to whom do you provide information?

3. What interdivisional problems does your section/bureau experience in the completion of its responsibilities?
4. What intradivisional problems does your section/bureau experience in the completion of its responsibilities?

5. What recommendations would you make to improve such problem areas?

By analyzing responses to these questions, I was able to identify integration-related problems and to generate recommendations regarding ways to improve division service delivery with fewer resources or without additional appropriations.

An additional step in the information gathering phase of this analysis involved reviewing national tax administration publications and interviewing knowledgeable Income Tax Division personnel to gain general insight into the steps other state Departments of Revenue are taking to meet the demands for service delivery with fewer resources. The steps taken by other states are reviewed in terms of their applicability to the Montana Department of Revenue’s circumstances.
CHAPTER II
ORGANIZATIONAL STRUCTURE

Before questions of integration can be analyzed, it is necessary to identify the organizational units and sub-units involved and the duties for which they are responsible. Toward this end, the first two sections of this chapter provide organizational descriptions of the Department of Revenue and the Individual Income Tax Division, along with brief descriptions of the responsibilities of each organizational unit. The flow of an income tax document through the Department and Division is described in the final section. The intent of this chapter is to provide the reader with a general understanding of the organizational context in which this analysis is conducted.

The Parent Organization, the Montana Department of Revenue

The Department of Revenue is organized into six operating divisions and three support service divisions (See figure 1). The operating divisions are the Income Tax Division, the Liquor Division, the Property Assessment Division, the Natural Resource and Corporation Tax Division, the Motor Fuels Tax Division, and the Miscellaneous Tax Division. The heads of five of the operating divisions report directly to the Director of the Department of Revenue. Because of recent efforts to automate division
Figure 1.
document processing, the Administrator of the Miscellaneous Tax Division is currently reporting to the Deputy Director of Operations. The operating divisions are organized along the lines of the major taxes the Department administers. The support service divisions are organized by specialty of support function.

The six operating divisions administer most of the state's taxes and some license fees, i.e., they are responsible for designing and mailing forms, interpreting laws and providing instructions to document recipients, auditing the tax documents submitted for accuracy and completeness, and assuring that taxes determined due are paid. With the exception of the Miscellaneous Tax Division and the Natural Resource and Corporation Tax Division, each division is responsible for administering one tax. The Miscellaneous Tax Division administers several different taxes and fees, such as tobacco taxes, inheritance taxes and store license fees. The Natural Resource and Corporation Tax Division administers the state's corporation income tax and natural resource severance taxes.

The remaining operating divisions administer one tax. The Individual Income Tax Division administers the state's individual income tax; the Liquor Division administers the liquor tax; the Motor Fuels Division administers the motor fuels tax; the Property Assessment Division administers the property tax. Each of the operating divisions maintains its
own audit and support service sections under the direction of an administrator. The audit sections are responsible for examining documents submitted by taxpayers to ensure accuracy and completeness, and to make every effort to ensure that each taxpayer required by law to file the documents and pay the respective taxes has filed and paid. Support service sections are responsible for document control, and word processing.

The support service divisions, Centralized Services, Data Processing, and Investigations and Enforcement, perform functions considered outside the administrative responsibilities of any one of the operating divisions. Each of these divisions performs tasks which support the administration of the state's taxes but are not directly controlled by any one of the operating divisions.

The Centralized Services Division is responsible for the internal control of Departmental appropriations, a central mail room service, maintenance of tax fund accounts such as the current year income tax fund into which current year income tax payments flow and out of which current year refunds are paid, and handling Department bad debt accounts. The segregation of these functions under a separate division is intended to provide an internal check on the use of appropriations, some cost savings, and greater departmental accountability.

The Data Processing Division handles department-wide
computer services needs, such as data entry into a mainframe computer and modifications in operating division computer programs. This Division also handles the Department’s statistical reporting requirements. These functions help moderate the use of common equipment and provide greater confidence in the Department’s statistical reporting. Computer services and statistical reporting also require personnel job qualifications that are not normally associated with the administration of any one tax. Tax administrators are less likely to understand the needs and functions of these professionals than an administrator specifically trained to manage a research division.

The Investigation and Enforcement Division is responsible for pursuing child support cases, a program requiring investigators to locate and collect child support payments from delinquent, non-custody parents. The Division also conducts liquor license background investigations on applicants for Montana liquor licenses to make certain they meet minimum standards. Finally, it conducts welfare fraud investigations. These particular functions require a law enforcement background and, for the most part, fall outside the normal functions of the tax-based operating Divisions.

The support service functions performed by the Office of Legal Affairs, and Office of Personnel and Training are not organized into separate divisions. They are maintained within the Director’s Office. These two functions also
require qualifications of its staff that fall outside the normal requirements of a tax based operating division. The Legal Affairs Division is responsible for all of the Department’s affairs that require legal counsel. These affairs include taxpayer appeals of operating division tax assessments, personnel actions brought against the Department by disgruntled former employees, and other Departmental liability suits. Under the direction of the Division’s chief counsel, staff attorneys are expected to specialize in specific taxes. One of the staff attorneys, for example, is assigned to all of the Individual Income Tax Division’s taxpayer appeals; another will be assigned all of the Property Assessment Division appeals.

The Office of Personnel and Training is responsible for developing and overseeing Department personnel policies. It is also responsible for developing training programs to meet the needs of the other Department divisions.

In summary, the operating divisions administer the taxes, while the support service divisions perform specific functions in support of the operating divisions that require job qualifications outside of those associated with the administration of any one tax, or the separation of which from the operating divisions enhances Departmental accountability. Within each division there are sub-units set up under the direction of an administrator to handle the functions or responsibilities assigned to that
division. Because this paper focuses on problems of integration within the Income Tax Division, its organizational structure is described in greater detail.

The Individual Income Tax Division

The Individual Income Tax Division comprises two bureaus, the Examining Bureau and the Administrative Services Bureau with five and three sections under each respectively (See figure 2). In general, the Examining Bureau is responsible for auditing documents that have been submitted to the division to ensure accuracy and completeness, and for making every effort to ensure that every individual who is required by law to file a document (tax return) and pay the individual income tax has filed and paid. The Administrative Services Bureau is responsible for document control (indexing and storing documents in such a manner that they are easily retrievable), word processing, and the collection of delinquent taxes.

The Examining Bureau’s responsibilities are spread among the five sections shown in figure 2. The Income Tax Office Examining Section is responsible for the examination of documents that can be reviewed from the Helena office location, i.e., review documents that contain questions of tax law or policy and do not require on-site record verification of amounts entered on the document. The Income Tax Field Examining Section is responsible for the
Figure 2.
examination of documents that require field examination, i.e., documents that not only contain questions of policy and law but also require on-site record verification of amounts entered on the documents. There are two withholding tax sections, the Withholding Office and Field Examining Sections, that perform essentially the same functions in regard to the withholding of the income tax on wages.

The final section under the Examining Bureau is the Tax Compliance Section. This section utilizes all available information to ensure all individuals who are required to file income tax documents and to pay state income taxes have filed and paid. If the section finds that an individual has Montana source income but has not filed a return, they will contact the taxpayer and take whatever action is necessary to achieve compliance.

The Income Tax Division is a highly centralized organization that places a great deal of emphasis on its audit function. The examining function, however, would come to a standstill without the completion of duties assigned to the administrative service bureau sections.

The Administrative Services Bureau contains three sections, the Records Section, Control and Data Section, and Collection Section. The Records Section is responsible for maintaining control over documents classified as active, i.e., documents selected for audit and on which action has been taken by one of the five examining bureau sections.
Action taken by one of the examining sections might involve correspondence containing a simple request for additional information by an examining section, field examination appointment letters, letters explaining why a document (tax return) was adjusted, and accounts receivable documents. To make them readily accessible, these documents are maintained separately from the bulk of the documents received by the Division which are defined as inactive and on which no action is being taken. The control section is also responsible for the Income Tax Division's word processing. All Division correspondence is generated by the control section.

While the Records Section is responsible for active document control and word processing, the Control and Data Section is responsible for inactive document control and current year document processing. The Control and Data Section is responsible for numbering and batching documents as they come into the Division from the Department's mailroom. Each document is reviewed by section clerical staff to make certain the document is signed and that the wages and state income taxes claimed as withheld on the document (tax return) equal the amounts shown on attached W-2s. The documents are then sequentially numbered and grouped together and assigned a batch number before being transferred to data entry. These functions are designed to ensure the accuracy of certain document data and to enable
Division personnel to track and locate documents after data entry. The section is also responsible for document storage after they have cleared all of the current year processing checks and to coordinate audit selections that are requested by Examining Bureau sections on documents held in storage.

In addition to its document processing, storage, and selection duties, the Control and Data Section also administers the estimated tax program for the Division. Individuals who are not wage earners and do not have state income tax withheld from paychecks are required to make estimated tax payments. The Control and Data Section maintains the estimated tax record keeping and performs all other associated duties.

The final section under the Administrative Services Bureau is the Collection Section. This section is responsible for the collection of delinquent taxes. Collection personnel contact individuals who have not paid amounts determined to be due the state by Examining Bureau personnel and take steps necessary to ensure that payments are made.

These organizational descriptions provide the reader with a general understanding of the organizations' structures and the duties for which each unit and sub-unit is responsible. It does not, however, reveal the interaction that is required between the units and sub-units for the organization to function properly. To illustrate
the interaction that occurs between organizational units and sub-units the flow of an Income Tax Division document through the organization will be described.

Flow of an Income Tax Division Document through the Department and Division

An Income Tax Division document is received in the Department's mailroom, a section under the Department's Centralized Services Division. If a payment is received with the document, it is transferred to the Centralized Services Division's Cashier Section before it is transferred to the Income Tax Division. If not, it is transferred to the Income Tax Division's Control and Data Section where it is reviewed to be certain it is signed and that attached W-2 items match the amounts entered on the document. It is then numbered and batched and transferred to the Data Processing Division for data entry into a main-frame computer.

The computer program is designed to check the document for math and certain procedural errors and to store the data in a master file. After the document data is entered into the computer it is returned to Income Tax Division Control and Data Section along with the rest of the batch in which it is stored. The batch is transferred to the Examining Bureau's Income Tax Office Audit Section. An error resolution work sheet generated by the computer program for each document containing math and procedural errors is included with the batch when it is transferred to the Income
Tax Office Examining Section. For purposes of illustration, let's assume an error resolution work sheet was generated on the document we are following. An office examiner must then review the document and correct the error. The correction results in a change in tax and the taxpayer must be notified. The examiner will also indicate which of several canned paragraph explanations should be sent to the taxpayer on the error resolution work sheet.

Let's further assume that additional tax is deemed by the examiner to be due the state. The corrections are made by the examiner on the error resolution work sheet, which is transferred back to the Control and Data Section, and then on to the Data Processing Division to enter the changes on the computer. The physical document is transferred to the Income Tax Division's Records Section for document control awaiting the statement of account (bill) and generation of an explanation for the adjustment via word processing. After the statement of account and explanation are sent to the taxpayer, the Records Section maintains physical document control until the tax is paid in full. The file is then closed and returned to the Control and Data Section for storage.

If payment is not received within sixty days the document is brought back to the office examiner to be "final noticed". The examiner requests a final notice, and the document is transferred back to the Records Section to await
the new statement of account with updated interest and additional penalty. In the accounts receivable system the account is transferred to the Collection Section for any further action. The Collection Section must now deal with the Control Section when physical file handling is required.

The above example covers only a fraction of the interdivisional and intradivisional interaction that takes place on a daily basis. Additional interactions will be illustrated in the succeeding chapters in which integration problems are identified. To include all of the interactions and associated needs for effective integration would require more space than is possible in this paper. However, the reliance of the Income Tax Division on other Department divisions, and the reliance of the Income Tax Division subunits on each other for efficient and effective transfers of information and documents should be clear from this example. The Division cannot carry out its responsibilities without the performance of tasks for which other Department divisions are responsible and, in addition, each of the Income Tax Division subunits are dependent on the others for functions outside their respective areas of responsibility. The Department and Division have segregated functions in such a manner that effective integration is absolutely required. What remains to be seen is whether the integration is effectively achieved.
CHAPTER III

INCREMENTAL REFORM VERSUS FUNDAMENTAL RESTRUCTURING

This chapter makes a distinction between incremental reform and fundamental restructuring, explains what other states are doing to meet similar demands for service with fewer resources, and clarifies why the author believes incremental change is what is warranted in Montana. Montana is not unique in its current economic difficulties. Other states have had similar difficulties which have been felt by their departments of revenue in the form of greater demands for services and fewer resources. Most of the departments have responded by searching for ways to maintain or improve service delivery.

What Other States Are Doing

State departments of revenue in this country are using one of two methods for improving departmental integration and service delivery. One method is to fundamentally restructure large segments of their organizations, i.e., convert from a tax type structure in which operating divisions are organized along the lines of the state's major taxes to a functional structure in which they are organized along the lines of particular functions performed. The second approach involves making incremental changes in policy and structure within existing structural shells.

The conversion to a function-based structure from a tax-
based or "product" structure requires a complete reorganization of operating divisions. If the Montana Department of Revenue reorganized along functional lines, for example, the Department might consist of one audit division, one control division and one or more additional support service divisions to perform the variety of other departmental functions instead of maintaining separate operating divisions to administer each tax. Under such a scheme, the one audit division would handle the examination of documents submitted on all types of taxes. The one control division would be responsible for all document control and storage.

This type of departmental structure has become increasingly popular among state departments of revenue. By 1981 nineteen states were employing a functional structure to administer their taxes.¹ Reasons often given for the conversion to a functional structure include better use of processing machinery, clerical staff, and technical skills. Two underlying reasons, however, are to enhance the exchange of information within the organization and to consolidate all of the contact required of each taxpayer.² In this context, it is relevant to note that the interdivisional exchange of information was cited by the interviewees in


²Ibid.
this analysis as a problem, the effects of which result in a severe reduction of division service delivery. If the purpose of this analysis is to find a solution to integration problems, a recommendation to convert to a functional structure might be in order.

The projected success of a functional structure, however, assumes some characteristics of the organization that do not exist within the Montana Department of Revenue. These characteristics include a limited number of tax types to administer, a similarity of documents reviewed for accuracy, a similarity of entities submitting these documents and a similarity of due dates for document and payment submission. If all a department administers is a sales and income tax, for example, a functional structure may make sense. The administration of both taxes involves reviewing sales documents for accuracy. The limited number of tax types means that a specific knowledge can be maintained by audit personnel. Imagine, however, the difficulty that would be faced by the Montana Department of Revenue in converting to such a structure. An audit staff would have to be trained to review diverse documents, entities, and due dates found in the fields of individual income, corporate income, property, motor fuels, natural resources and inheritance tax. The immensity of this task alone may prohibit such a move.

Because of such difficulties, not all the state
departments of revenue that have converted to this type of structure have had a satisfactory experience. The Idaho Department of Revenue, for example, recently functionalized its audit programs. Within their audit division, personnel are organized into audit groups. At the head of each group is an audit leader. Initially, each group handled a share of all audit division functions such as field, office and compliance audits of both corporations and individual income tax. For the most complex audits, audit group leaders were combined to form an audit task force. Within each group areas there were no areas of specialization and very few hierarchical tiers.

The Idaho Department of Revenue encountered problems which forced it to make changes. Correspondence and other matters piled up on group leaders who were often involved in complex corporate audits and not able to devote enough time to day to day operations. Some payments were not recorded in a timely manner and correspondence went months without answer. The problems experienced by the State of Idaho were primarily due to a lack of authority delegation and a lack of specialized expertise. When audit group leaders were devoting their time to complex corporate audits their staffs did not have the authority to make decisions or opportunity to discuss matters with the group leaders. No one was

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3Mr. C. Erwin Hall, interview by author, Written recording, Helena, Montana, 6 December 1985.
provided the opportunity to develop enough specific knowledge in any one tax or sub-specializations of these taxes.\footnote{Ibid.}

To a degree Idaho's problems have been solved by establishing intra-group hierarchies, and by an increase in tax specialization within and throughout each group. Audit groups and/or individuals within each group have become specialized again.\footnote{Ibid.} In short, it appears that to solve problems associated with the conversion Idaho has taken steps back toward a product or tax type organization.

The other method of reorganization I have generalized under the heading of "making incremental changes within existing structural shells". Much like a management by objectives approach this method requires a department to first identify a function in need of improvement. Instead of reorganizing the entire department on the basis of what may be purely speculative improvements in organizational service delivery, all of the factors contributing to the failure or lack of success of a particular function are thoroughly examined. Recommendations on changes in structure or policy are then made in an effort to improve service delivery and the results of the changes are monitored and fine tuned. In taking this approach, goals can be set and improvement measured.
A good example of this type of approach can be found in the District of Columbia's restructuring of its compliance prosecution program. The District was experiencing an extraordinarily high percentage of tax compliance prosecution cases in which no sentence was imposed when taken to court. Because of the wasted manhours involved and prosecution section frustrations, this program was identified as needing improvement. It was then examined for factors contributing to the large number of cases in which no sentence was imposed per total case load.6

It was discovered that a separate section, under a separate authority and in a separate physical location, was responsible for the identification of compliance cases. Once their work was completed the cases were submitted to the prosecution section. It was also discovered that this same section would often uncover facts that would have resolved a case but it rarely notified the prosecution section.

The District solved this problem by combining both sections under one authority and in the same physical location. Cases in which no sentence was imposed per total case load dropped from 73% to 26% in a very short period of time. The total case load also dropped by 70%.7 The


7Ibid.
function was improved without disrupting the departmental structure.

**What Montana Has Done**

Other examples of the incremental approach can be found in recent changes to structure and policy made by the Montana Department of Revenue. In order to consolidate corporate audits and out-of-state travel under one division, the Department combined the Corporation Tax Division with a section formerly under the Property Assessment Division, which dealt extensively with out-of-state corporations on natural resource net proceeds taxes, and a section formerly under the Miscellaneous Tax Division, which dealt extensively with out-of-state corporations on natural resource severance taxes. The Department also established a policy whereby each operating division field audit unit will conduct a cursory withholding tax audit at the conclusion of their specialized audit. Motor Fuels Tax auditors, for example, will conduct a withholding tax audit as part of their normal audit programs.

In both of these examples functions needing improvement were first identified: consolidated dealings with corporations, out-of-state travel coordination, and withholding tax audit coverage. Only after careful consideration were recommendations made to incrementally change organizational structure and policy to enhance Departmental integration while maintaining the basic
structural shell.

The incremental approach offers a more traditional approach to solving organizational problems, specifically integration problems. The same organizational shell is maintained unless carefully considered evidence indicates one or more of the department or divisional sub-units is unnecessary or should be combined with other units. Incremental changes within the organization are made only after careful consideration of problems. This allows the organization's leadership to specifically identify a function in need of improvement. The method also allows leadership to consider the specific sources of problems when designing solutions.

The above analysis suggests that the incremental approach to solving organizational integration problems is best suited to Montana's existing organization structure. Major organizational restructuring, therefore, will not be part of the following recommendations to improve Divisional integration. The recommendations will also follow the basic outline used in describing integration problems and their associated opportunities to improve service delivery. They will be analyzed under the two levels of organizational integration, interdivisional and intradivisional, and in terms of the evaluation criteria outlined in Chapter I.
CHAPTER IV
IDENTIFICATION OF INTERDIVISIONAL INTEGRATION PROBLEMS

Interviews with each of the section supervisors and bureau chiefs were designed to determine whether or not interdivisional integration problems existed. Interviewees were asked questions that related specifically to the criteria outlined in Chapter I: efficient transfers of documents, efficient exchanges of information, effective use of existing personnel, and effective use of existing equipment. Analysis of interview results revealed three integration problems as well as opportunities for improving Division service delivery.

Interdivisional Integration Problems and Recommended Solutions

The description of the flow of an Individual Income Tax document through the Department and Division contained in Chapter II suggested the importance of effective interdivisional integration. This was confirmed by the interview results. When Division personnel were asked, for example, to identify the sources of document and information input to their respective units and sub-units and to identify specific interdivisional integration problems, it became apparent that some of the Department's support services divisions handle Division documents at certain points in the process and that other Department operating
divisions maintain information essential to the Income Tax Division. It also became apparent that other division personnel work on programs that involve the Income Tax Division, and that some equipment is shared by all of the operating divisions. Each Division unit and sub-unit interacts with and is dependent on other divisions for the performance of functions that enable them to complete its respective tasks. It was, therefore, surprising to find that aside from one major problem relating to the interdivisional transfer of information, only a few, relatively minor complaints were identified.

Efficiency of Document Transfers

The first criterion for evaluating organizational integration relates to the efficiency with which Income Tax Division documents are transferred. Interdivisionally, no substantive concerns were expressed over the transfers of documents despite the frequency of transfers outlined in the example contained in Chapter II. While shifts in mail room, cashier's office, and data processing priorities occasionally delay Income Tax Division document processing and transferring of documents, the delays are short-lived and rarely cause any great concern within the Division. Nor do they severely hinder Division service delivery. Given the Department's commitment to centralizing the mail room, cashier and data processing functions, priorities appear to be logically set and the associated interdivisional transfer
of Income Tax Division documents efficient.

Analysis suggests that there are three reasons for the absence of problems in the interdivisional transfers of documents. First, the Department's priority use of the afore-mentioned centralized functions is established with an eye on the peak period demands placed on the operating divisions. In setting priorities, for example, the Department leadership considers the fact that the Income Tax Division's peak period of demand is from January 1 to April 15 of each year, and will assign appropriate time and personnel to the Division's document processing. Second, operating division peak periods of demand do not for the most part, overlap. Corporation documents, for example, are not due to be submitted to the Natural Resource and Corporation Tax Division until a month after Individual Income Tax documents. Finally, there appears to be good communications between the Department's support service divisions and operating divisions. If problems over the prioritized use of the central functions arise they are quickly communicated and resolved.

Recommendation: None required.

Efficiency of Information Exchange

The second criterion for evaluating organization integration relates to the efficiency with which information is exchanged. When asked to identify interdivisional problems relating to the exchange of information, the
interviewees expressed great concern. The specific problems identified can be reduced to one general problem, the lack of a common department-wide data base. While each operating division maintains information that is valuable to other operating divisions in the administration of their respective taxes, the data is not held in a format that allows for automatic correlation with another division's data using the central computer. Data correlation requires a great deal of manual labor and the Department can never be certain it is using all of the information available in the administration of the state's taxes unless each operating division manually records and transfers the data deemed valuable to other operating divisions.

The information considered valuable to the Income Tax Division that is maintained by other operating divisions is normally income information that, when correlated with the Division's information, helps ensure that each individual taxpayer is reporting and paying tax on all of his or her income. The Natural Resource and Corporation Tax Division, for example, administers the state's Sub-Chapter S Corporation program. This Division controls the corporation returns that are submitted, reviews the documents to make certain that the corporation meets minimal standards that allow it to file as a Sub-Chapter S Corporation and that the $10.00 filing fee is submitted with the return. Sub-chapter S Corporation income, however, is taxed at the individual
shareholder level. Each individual shareholder in these corporations reports his or her share of the income and pays an income tax on his or her individual income tax return. The only amount paid by the corporation is the $10.00 filing fee.

When the Department first automated the processing and information storage on these corporate returns the Natural Resource and Corporation Tax Division also determined what data would be captured and the format for storage. Because the income taxes on Sub-Chapter S Corporation income are paid by the shareholders on their individual income tax returns, the Natural Resource and Corporation Tax Division's principal concerns are to make certain that a valid election is filed by the corporation to be taxed as a Sub-Chapter S Corporation, that the $10.00 filing fee is paid, and that certain procedural steps are taken in the completion of the corporation document. While these documents contain the names, social security numbers, addresses and amounts of income distributed and taxable to each individual shareholder, all of which is important in the correlation with Income Tax Division information, it is not held in a format that allows for an automatic cross-match with Income Tax Division information using the central mainframe computer. The taxation of this income was outside the Natural Resource and Corporation Tax Division's administrative responsibilities and as a result the format
compatibility of the data stored with that of the Income Tax Division had not been perceived as important.

The correlation of information from the Sub-Chapter S Corporation returns with Income Tax Division information is a time-consuming process. The Sub-Chapter S Corporation must first be identified as a possible source of income to a taxpayer by Income Tax Division personnel. If the Division wishes to review the corporation document to be certain the corporate income is reported, a request slip is filled out for the corporation document and submitted to the Natural Resource and Corporation Tax Division. The Division then pulls the document and transfers it to the Income Tax Division. This is a very time-consuming process and one in which the Income Tax Division cannot be certain it has utilized all available information from the Sub-Chapter S documents unless each of the Corporation documents is reviewed and the information manually correlated with Income Tax Division information.

Sub-Chapter S Corporation documents are not the only source of information maintained by another operating division that is valuable to the Income Tax Division. From a recently published catalog of data maintained by all of the Department's operating divisions, the Income Tax Division leadership identified information maintained by each of the other operating divisions as potentially valuable to the administration of the state's income tax.
None of this data, however, is maintained in a format that can be automatically correlated with Income Tax Division information.

This particular problem comes as no great surprise considering the manner in which the Department initially automated the processing and storage of information contained in documents submitted to each of the Department's operating divisions. When the Department first automated document processing and data storage in the late 1960s each operating division was allowed to determine its own processing and storage needs separately. In addition to the fragmentation of decision making, each of the operating divisions dealt with the Department of Administration's computer specialists separately to develop the mechanics of their particular programs. The computer specialists were concerned only with the mechanics of each separate program. No one individual, organization unit or sub-unit was concerned with the interdivisional compatibility of the data stored.

According to the interviewees, the Department had long recognized the inefficient exchange of information as a problem and had requested funding from the legislature to consolidate departmental information. The 1985 Montana Legislature approved the funds for the consolidation of information. However, at the time of this writing the merger has not been completed.
Recommendation: Complete data base changes as soon as possible by hiring additional computer program specialists and devoting necessary departmental resources.

The cost of such a move is significant but according to the interviewees, the benefits of improved service delivery will far outweigh the financial cost. As a result of these changes Division personnel will be able to review more documents for accuracy and completeness.

Effective Use of Existing Personnel

The third criterion for evaluating organizational integration relates to the effectiveness with which existing personnel are used, i.e. the use of audit, control and administrative personnel. Because each division employs specialists to handle only internal division matters, no major interdivisional problem was expected. Each operating division is responsible for the administration of a different tax and maintains a separate staff to meet the demands associated with the administration of its tax. The support service divisions perform tasks considered outside the normal functions of any one operating division and employ specialists to meet the demands of their respective tasks. There were, however, two minor concerns expressed by the individuals interviewed. Both of the concerns dealt with the manner in which the Centralized Services Division, a support service division, handles certain matters.

First, the Centralized Services Division maintains three separate accounts into and out of which income tax funds flow. They are the current income tax fund, the delinquent
income tax fund, and the amended income tax fund. Because the Income Tax Division is continually handling matters that involve each of these funds and the identification of money flowing into and out of each fund is essential for statistical reporting purposes, care must be taken to choose the proper account into which payments are deposited and out of which refunds are paid. Centralized Services personnel do not always know which account to use and must rely on the Records Section supervisor to identify the proper account. Of late this task has taken more and more of the supervisor's time which represents time away from managing the Records Section.

Recommendation: Consolidate the three funds into one account and code the transactions. A numeric code would represent each of the three income tax funds as required for statistical reporting purposes. By making this change the cumbersome correction procedure currently used would be eliminated and the Records Section supervisor could spend more time managing the section.

The other minor complaint involving the effective use of existing personnel relates to the manner in which bad debt accounts are managed by the Centralized Services Division. When the Centralized Services Division receives a bad debt account from the Income Tax Division it does not receive the documentation which supports the debt owed the state due to disclosure limitations placed on the Income Tax Division. When Centralized Services sends the account to a private collection agency there are frequently questions regarding the validity of the debt. The Centralized
Services Division cannot answer the questions and must refer them to the Income Tax Division Administrative Services Bureau Chief. The Bureau Chief must then devote a great deal of time to the matter even though the account is no longer the Division's responsibility.

Recommendation: Transfer the bad debt physical files to the Audit and Accounting Division. Audit and Accounting personnel are employees of the Department of Revenue and, as such, are not precluded from access to Individual Income Tax documents by disclosure of information laws. The transfer of these files would relieve the Support Service Bureau Chief of the bad debt verification task and allow him to devote more time to Individual Income Tax Division matters.

Effective Use of Existing Equipment

The final criterion for evaluating organizational integration relates to the effectiveness with which existing equipment is used. The only significant piece of equipment identified by those interviewed as common to all of the operating divisions was the Department's computer data entry equipment. Each operating division has its own goals and priorities and when they each must compete for the use of common equipment conflicts and associated reductions in division service delivery might be expected. However, little concern was expressed by the division personnel interviewed over the common use of the Department's data entry equipment. Like the Division's experience with interdivisional transfers of documents the use of this equipment is based on prioritized division needs. During peak filing periods when a division needs the computer data
entry capabilities the most, that division is given priority. Only on rare occasions will departmental data processing priorities shift away from an operating division during its peak periods of need. Because these occasions are rare they do not severely hinder division service delivery.

The reasons for the absence of problems relating to the interdivisional use of existing equipment are the same as those for the efficient interdivisional exchange of documents. The Department leadership assigns data entry equipment time and personnel based on peak periods of need, and operating division peak periods of demand do not for the most part overlap. When problems do arise they are quickly communicated and resolved.

Recommendation: None required.
CHAPTER V
IDENTIFICATION OF INTRADIVISIONAL INTEGRATION PROBLEMS

Interviews with each of the section supervisors and bureau chiefs were also designed to determine whether or not intradivisional integration problems existed using the evaluation criteria outlined in Chapter I: efficiency of document transfer, efficiency of information exchange, effective use of existing personnel and effective use of existing equipment. Analysis of the results revealed several integration problems as well as opportunities for improving division service delivery.

Intradivisional Integration Problems and Recommended Solutions

During the interviews with Income Tax Division personnel it also became apparent that effective intradivisional integration is necessary for the Division to maintain or improve service delivery. When asked to identify sources of documents and information necessary for their respective units to perform their requisite functions and to whom each supplied documents and information, each of the personnel interviewed for this analysis indicated they interacted with all of the Division’s other bureaus as well as sections within those bureaus. All of the Division units and sub-units use common equipment and all functions performed by Division personnel are interrelated.
Intradivisional integration problems were identified relating to each of the evaluation criterion.

Efficiency of Document Transfer

Results from interviews revealed three problems involving the efficient transfers of documents within the Division. The first problem relates to active document control. Active documents are documents on which an Examining Bureau Section or the Collection Section has taken action that are maintained separately from the bulk of documents stored by the Division. Active document control is a duty for which the Records Section is responsible. Examining Bureau and the Collection Section personnel frequently require the physical document for follow-up action or correspondence. According to the Examining Bureau supervisors and the Collection Section supervisor, these documents are frequently misplaced and cannot be retrieved without a great deal of effort devoted to locating them. The Records Section is not immediately able to retrieve the documents either because they are misfiled by Section personnel or because Examining Bureau and Collection Section personnel failed to use established procedures for file transfer. Examining Bureau and Collection Section personnel will, at times, simply carry a document they have checked out of the Records Section to another auditor or collection specialist without notifying the Records Section. The next time a request for this file is submitted to the Records Section it
will not be in their file system nor will there be any indication of its location. A great deal of the Division’s resources are devoted to locating these document which hinders the Division’s service delivery.

Further analysis of this problem reveals what appears to be the primary reason for the frequent misplacement of active documents. In recent years the Division has invested a great deal of resources toward building its examination capabilities by increasing staff, equipment, and automated examination programs. The Division has also improved the speed with which it can process letters and statements of account. It has not, however, devoted any additional resources to improving the control capabilities of the Records Section. The Section is still using an archaic file cabinet and control card system to index, store and keep track of active physical files. This system requires the Records Section staff to enter by hand data concerning the location of active files on a file card. Files that are returned or submitted to the Records staff for filing are manually placed in appropriate file cabinets. The additional work load brought on by improvements in the Division’s audit and correspondence capabilities increases the exposure to filing errors.

Recommendation: The ideal solution to this problem would be up-dating the document storage equipment used by the Records Section and/or computerizing the records management system. This might involve purchasing a lektriever or other automated storage equipment and investing in a computerized records management system.
However, considering the budget constraints involved, updating equipment is not a realistic solution. In lieu of the ideal, the Division could train the Records Section staff regarding the importance of maintaining ready access to physical files for audit bureau and collection section staff. Examining bureau and collection section staff could also be trained on the importance of following prescribed procedures for transferring files to other Division personnel. This solution will at least provide personnel with an appreciation for one another's tasks.

The second integration problem identified by the interviewees and included under the transfer of documents criterion involves the location of current year active documents on which error resolution work sheets (ERWS) have been generated but not cleared by Examining Bureau personnel. The Control and Data section is responsible for tracking and making sure each ERWS has been cleared by year end. Every year this section spends an inordinate amount of time locating documents on which ERWS have been generated but not cleared and requiring Examining Bureau personnel to complete the ERWS.

Because it is easier for Examining Bureau personnel to make corrections to the documents when an examination is completed using an ERWS, they will delay completing the ERWS until they have received sufficient information from the taxpayer to complete the audit. As the year progresses each member of the Examining Bureau responsible for completing ERWS's accumulates several uncompleted ERWS's. By year end the total number of uncompleted ERWS's can reach a substantial number requiring the Control and Data Section
Supervisor and at least one additional individual to spend from two to four weeks at year end locating these ERWS’s and associated documents. During this period of time they can devote little time to other Control and Data duties, such as facilitating document processing and maintaining the estimated tax program.

Recommendation: Locate documents with uncompleted ERWS’s at shorter intervals. The Control and Data Section supervisor could distribute a list of documents monthly or quarterly to Examining Bureau personnel and require them to locate the documents. The process would not only help monitor document locations on a continuing basis but would also serve as a reminder to Examining Bureau personnel to complete the document review.

No additional expenditure would be required since the Control and Data supervisor already receives monthly and quarterly ERWS reports. No additional time would be required of the examining bureau personnel either. Examining bureau personnel are required to periodically review their active files temporarily on hold awaiting additional information. A report issued by the Contol and Data Section at monthly or quarterly intervals would assist them in this task.

The final integration problem identified by the interviewees relating to the transfer of documents is one of three problems that exists within the Examining Bureau. The two remaining problems involve the efficient transfer of information and effective use of personnel. Each problem will be addressed under the appropriate evaluation criteria. It should be noted at this point that documents selected for audit are not entirely generated by current year processing of documents through the Division’s computer program. Each of the Examining Bureau sections may run audit selections on documents held in storage by listing specific criteria for

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an audit selection and submitting it to the Control and Data section. Documents that meet the criteria are then retrieved by the Control and Data section and submitted to the appropriate audit section.

Not all of the documents selected can be effectively examined by the section initiating the selection. If the examination of the document could be better handled by one of the other audit sections, procedures are in place for the document to be transferred. Income Tax Field Exam, for example, might run a selection and identify several documents requiring an audit. Some of the documents selected require only desk review, (for instance, they contain questions of tax law or theory and do not require on-site record verification). Income Tax Office Exam is better suited to handle desk reviews because of its automated processes and experience developed over the years with desk reviews. The Field Examining Section may keep the file and either complete the exam in the field or make any necessary adjustments from the office. In this example not only was the document not transferred, but personnel were not used optimally.

The participants and the roles they play are not limited to the above example. Each of the sections was cited by one or more of the Examining Bureau personnel interviewed as possibly holding on to files the examinations on which would be better handled by another section. They base their
concerns on the fact that once prolific sources of documents to be audited have dried up in recent years. They also become aware of another section’s activities when certain cases are appealed by taxpayers. Information that comes out in the appeal process indicates that the document audit should have been handled by another section.

**Recommendation:** Set up general policy guidelines on the transfer of audit files within the bureau with input from each of the Audit Bureau supervisors and guidance from the Audit Bureau Chief. The guidelines would serve as a reminder to supervisors reviewing files selected for audit and as a reference document during disputes regarding audit files.

**Efficiency of Information Exchanges**

The interviewees identified only one integration problem relating to the intradivisional transfer of information criterion. It is the second problem contained within the Examining Bureau cited above. Concern was expressed by Examining Bureau personnel that tax law and regulations were not being uniformly interpreted by each Examining Bureau section. Disagreement is sometimes expressed on certain tax issues such as the circumstances that must exist before the Division may tax the interest income earned by a non-resident Montana taxpayer on the installment sale of Montana property. The disagreement is exposed but little is done to set a concrete policy. There is a risk that each section may be following different policies regarding the same issue. In fairness to the Examining Bureau sections it should be noted that there will always be circumstances
unforeseen by the authors of legislation and administrative rules which require a case by case analysis. However, based on the testimony of those interviewed the problem which exists goes beyond a case by case interpretation. They feel that at least one section will at times develop an informal policy on these types of issues that may conflict with other sections' positions. This policy or information is not shared with other sections lest there be disagreement and a possible suspension of the policy.

Recommendation: Set up general policy guidelines on issues that require case by case analysis. The guidelines need not cover anticipated case circumstances or state conclusions to be reached under these circumstances. They could, however, identify specific aspects of each case that should be tested before a conclusion is made. Before making a decision to tax a portion of a nonresident's interest income, for example, personnel should be certain all of the specified aspects of the case have been tested.

Effective Use of Existing Personnel

Two problems were identified by the interviewees that relate to the use of existing specialists criterion. The first is the last integration problem within the Examining Bureau. Because files are not frequently transferred between Examining Bureau sections the Division cannot be certain that the appropriate Examining Bureau personnel are optimally handling each document examination. Continuing with the example used to illustrate the Examining Bureau problem under the transfer of documents criterion, if Income Tax Field Exam personnel conduct desk reviews, reviews for
which Income Tax Office Exam is better suited, it logically follows that the reviews were not conducted in the most efficient manner. It also logically follows that the Field Exam personnel conducting desk reviews are not fulfilling the responsibilities for which they are employed, i.e., conducting field audits. When documents are not transferred, bureau personnel are not being effectively used.

Examining bureau sections are hesitant to transfer files primarily because of the method chosen to account for new employees each Examining Bureau section acquired in the 1985 legislative session. These positions were defined as "sunset positions", i.e., positions that will be lost in the succeeding legislative session unless the legislature takes a positive action. The legislature conditioned future approval of funding for the positions by requiring the Division to assess and collect a specified amount of income tax in fiscal year 1986 over fiscal year 1984. In other words the Division has to bring in more revenue as a direct result of the sunset positions. The Division leadership chose to account for the additional revenue assessed and collected by assigning a share of the total to each sunset position. If the Division does not meet the overall goal, the assumption is that at least some of the positions can be salvaged if they have met their share of the goal. Because each section fears the loss of some productivity and newly
acquired positions they are hesitant to transfer files.

**Recommendation:** Abandon the method of accounting for sunset employee position productivity by assigning a share of the overall sunset goal to each separate position. Instead, assign the additional productivity required to maintain the positions as an overall bureau goal. There would then be an incentive to make certain each examination would be completed as efficiently as possible by the proper personnel.

The final intradivisional integration problem identified under the heading of effective use of existing personnel criteria is the volume of administrative tasks handed down to Examining Bureau Section Supervisors from the Division Administrator and the Examining Bureau Chief. These administrative tasks include budget preparation, writing proposed legislation and administrative rules, acting as informal conferees on document adjustments under appeal, setting-up and serving on hiring panels to fill vacant positions, writing suggested responses to letters addressed to the Department Director or Division Administrator and fulfilling any other request made of the Division and handed down by the Administrator and Bureau Chief. The section supervisors naturally expect to fulfill these kinds of duties but some individuals feel they are having an adverse effect on the attention given to and the performance of their sections. The completion of these tasks takes time, time away from planning and directing the activities of the sections.

The reason for this phenomenon is obvious. The number, diversity, and complexity of these tasks is such that no
administrator and bureau chief could complete all of them and maintain control over the division or bureau. The tasks are therefore delegated to individuals in the next level of the organization's hierarchy with the ability and expertise to handle them, the Examining Bureau Section Supervisors. Each of the Examining Bureau Supervisors expressed great concern that these administrative tasks were having an adverse impact on their respective sections' service delivery.

While these administrative tasks should not be considered outside the responsibilities of section supervisors, it might be said that the Division is not truly utilizing existing personnel as effectively as possible in this instance if there is a way to relieve them of at least part of the tasks. Relief from some of these tasks might enable the supervisors to spend what they perceive to be adequate time planning and directing the activities of their sections.

Recommendation: Borrow from the division's personnel vacancy savings and create an administrative task support position. At the time of this writing the division has enough in vacancy savings to cover the cost of the position. The position could be placed directly under and be accountable to the administrator. This position could be assigned the tasks of budget coordination; writing rules, proposed legislation and interview questions; sitting on most of the division's hiring panels and acting as the informal conference conferee as the occasions arise. A substantial portion of the administrative tasks burdening the Audit Bureau supervisors would be re-assigned which would allow them to spend more time directing their respective sections.
Effective Use of Existing Equipment

The final criterion chosen by which to evaluate intradivisional integration is the effective use of existing equipment. Under this criteria only one problem was identified by one section supervisor. The problem is the Divisional priority use of word processing equipment. The Collection Section supervisor feels that when both his section and an Examining Bureau section have a volume of work in word processing a decision is normally made to give the Examining Bureau section priority over Collection for the use of word processing equipment. According to the Collection Section supervisor, the longer it takes his section to make its initial contact with delinquent taxpayers the more its effectiveness is diminished. The more the section’s effectiveness is diminished the less revenue it will collect from delinquent taxpayers.

The Examining Bureau work in word processing that is competing with the Collection Section work is normally the initial notification to the taxpayer that he owes an additional tax along with an explanation for the tax. According to the Examining Bureau Chief the Division on average will receive payments in full from this initial mailing from 54% of those notified. By the time the Collection Section receives documents on which it must collect delinquent taxes the easy or "automatic" collection has been reaped. Those contacted by the Collection Section
are therefore less likely to pay their respective taxes. By making this priority shift toward the Audit Bureau word processing work the overall collection of taxes by the Division is facilitated. Times are changing, however. The state's economy is depressed and the percentage of automatic collections is decreasing along with the state of the economy. There may soon come a time when the results of the collection section word processing work should take precedence over audit bureau word processing.

Recommendation: Require the Audit Bureau Chief and Collection Section Supervisor to meet periodically and compare relative rates of return (percentages of taxpayers who make payments as a result of the two different kinds of correspondence). While the audit bureau correspondence is currently maintaining a greater rate of return, the state of the economy appears to be closing the gap. Periodic meetings such as this could ensure the division does not miss a point in time when the Collection Section correspondence rate of return exceeds that of the Audit Bureau necessitating a shift in the prioritized use of word processing equipment.
CHAPTER VI

SUMMARY

In summary, the interviews with Division personnel revealed several integration problems. Interdivisionally, the problems were limited to the lack of a common department-wide data base and two relatively minor problems regarding the use of Division personnel to complete tasks for which the Centralized Services Division is responsible.

Intradivisionally, integration problems were identified relating to each of the four criteria used to evaluate Division integration. Under the efficient transfer of documents criterion the interviewees cited problems in retrieving active documents from the Records Section, the volume of uncompleted ERWS's at year end that must be located and completed, and the infrequent transfers of documents between Examining Bureau sections. The interviewees cited the hesitance to share information on policy matters within the Examining Bureau as a problem relating to the efficient transfer of information. Problems relating to the effective use of existing personnel criterion were the ineffective use of Examining Bureau personnel and the Examining Bureau supervisors' loss of time devoted to their sections because of the volume of administrative tasks they are asked to complete by the Division Administrator and Examining Bureau Chief. Finally,
under the effective use of existing equipment criterion a problem was cited by the Collection Section Supervisor regarding the use of the Division word processing equipment. He feels that the Division’s decision to give Examining Bureau work in word processing priority over Collection’s work is diminishing his section’s ability to collect taxes due the state.

Recommendations to solve these integration problems were made under the premise that an incremental approach to reform is appropriate for the Montana Department of Revenue and its Income Tax Division. No fundamental restructuring recommendations were made. The number and diversity of taxes administered by the Montana Department of Revenue requiring the maintenance of specific knowledge and the problems associated with cross training examination personnel may preclude the use of a fundamental restructuring method such as functionalization. The benefits of the incremental approach to solving integration problems such as, designing solutions to fit the sources of problems and the ability to set goals and measure improvement also provide an incentive for using the incremental reform method to prescribe solutions.

By adopting recommendations contained in Chapters IV and V, documents would be transferred more efficiently; information would be exchanged more efficiently; existing specialists would be used more effectively; and existing equipment will
continue to be used effectively. Making these changes would improve Division and Department integration and, logically, improve Division service delivery without additional resources.
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