


DEPARTMENT OF TAXATION

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2025

Auditor of Public Accounts
Staci A. Henshaw, CPA
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AUDIT SUMMARY

Our audit of the Department of Taxation (Taxation) for the year ended June 30, 2025, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth's accounting and reporting system, Taxation's internal accounting and reporting system, and supplemental information and attachments submitted to the Department of Accounts (Accounts);

- one matter involving internal control and its operation necessary to bring to management's attention; however, we do not consider it to be a material weakness;

- four additional matters involving internal control and its operation requiring management's attention that also represent instances of noncompliance with applicable laws and regulations that are required to be reported under Government Auditing Standards; and

- corrective action has not been completed with respect to the prior audit findings identified as ongoing in the Findings Summary included in the Appendix.

Our report includes a risk alert that requires the action and cooperation of Taxation's management and the Virginia Information Technologies Agency (VITA) regarding risks related to unpatched software.

In the section titled "Internal Control and Compliance Findings and Recommendations," we have included our assessment of the conditions and causes resulting in the internal control and compliance findings identified through our audit as well as recommendations for addressing those findings. Our assessment does not remove management's responsibility to perform a thorough assessment of the conditions and causes of the findings and develop and appropriately implement adequate corrective actions to resolve the findings as required by Accounts in Topic 10205 – Agency Response to APA Audit of the Commonwealth Accounting Policies and Procedures Manual. Those corrective actions may include additional items beyond our recommendation.

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INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Improve Tax Return Processing Reconciliation Controls

Type: Internal Control
Severity: Significant Deficiency

The Department of Taxation (Taxation) does not properly perform and document the daily reconciliation of one of its online tax return submission channels. Taxation uses these reconciliations to detect data transmission errors between its online tax return submission channels and its taxpayer accounting system. Of the four daily reconciliations we reviewed for this specific channel, one reconciliation (25%) did not agree to supporting records. Upon further analysis, we noted 20 additional reconciliations with discrepancies: 19 reconciliations did not match supporting records, and two reconciliations contained discrepancies between the taxpayer accounting system and the tax return submission channel for which there was no evidence of remediation. These errors are attributable to a lack of attention to detail when entering data and insufficient review.

Taxation's tax return submission channel reconciliation procedures require the performance of daily reconciliations. These reconciliations must be accurate to enable Taxation to effectively detect and resolve data transmission errors. Failure to accurately complete reconciliations may prevent the remediation of errors that occur during transmission and could result in lost tax forms. Lost tax forms pose reputational damage to Taxation and may also result in Taxation applying improper interest and penalties to the taxpayer's account, or delayed refunds.

Taxation should improve its reconciliation process to ensure it is able to detect data transmission errors. Taxation should also enhance the reconciliation review process to ensure staff accurately prepare the reconciliation and document the resolution of discrepancies.

Revoke Systems Access for Separated Employees in a Timely Manner

Type: Internal Control and Compliance
Severity: Significant Deficiency
First Reported: Fiscal Year 2023

Taxation did not timely revoke systems access for separated employees. Of the 113 terminated employees tested, Taxation did not timely remove access for 13 separated employees (12%) due to delayed separation requests. Managers submitted separation requests between two and 52 days late. The delays in submission were due to the managers being unaware of their responsibilities and, in some instances, overlooking the need to submit a separation request. The Commonwealth's Information Security Standard, SEC530 (Security Standard), requires agencies to disable information system access within 24 hours of termination. Additionally, Taxation's internal policy requires access be removed no later than the employee's last workday.

Untimely removal of user access can compromise the integrity of Taxation's internal systems and increase the risk of unauthorized transactions. Taxation should timely revoke systems access for separated employees and should ensure that managers understand their responsibility for submitting separation requests timely.

Develop and Implement a Third-Party Service Provider Oversight Process

Type: Internal Control and Compliance
Severity: Significant Deficiency
First Reported: Fiscal Year 2023

In our prior report, we identified that Taxation made progress to develop and implement a documented process to identify, procure, maintain, and monitor external service providers that store, transfer, and process Taxation's mission-critical and confidential data in accordance with the Security Standard. However, Taxation has not yet implemented its documented process and does not expect to complete corrective actions to remediate the prior finding until the end of fiscal year 2026. As management plans to complete corrective actions after the fiscal year under review, we will evaluate whether the corrective actions achieved the desired results during a future audit.

Improve Database Security

Type: Internal Control and Compliance
Severity: Significant Deficiency

Taxation did not implement some required security controls for a database that supports its financial accounting and reporting system in accordance with its internal policies, the Security Standard, and industry best practices, such as the Center for Internet Security Benchmarks (CIS Benchmark). We communicated three control weaknesses to management in a separate document marked Freedom of Information Act Exempt (FOIAE) under § 2.2-3705.2 of the Code of Virginia due to it containing descriptions of security mechanisms.

Taxation's policies, the Security Standard, and CIS Benchmark require and recommend implementing specific controls to reduce unnecessary risk to the confidentiality, integrity, and availability of Taxation's mission-critical systems and data. Taxation did not implement the required and recommended settings due to an oversight within its baseline configuration document and delays with an ongoing project.

Taxation should implement the security controls mentioned in the FOIAE communication to ensure the configuration aligns with its internal policies, the Security Standard, and CIS Benchmark. Improving database security will help maintain the confidentiality, availability, and integrity of Taxation's sensitive and mission-critical data.

Improve IT Risk Management Program
Type: Internal Control and Compliance
Severity: Significant Deficiency

Taxation does not manage its information technology (IT) risk management program in accordance with its internal policies, the Security Standard, and the Information Technology Resource Management Data Classification Standard, SEC540 (Data Classification Standard). Risk management documents include Taxation's Business Impact Analysis (BIA), IT System and Data Sensitivity Classification (Sensitivity Classification), IT System Risk Assessments (RA), and System Security Plans (SSP). The following four weaknesses exist:

- Taxation does not classify eight of its 72 (11%) IT systems identified in its Sensitivity Classification as being sensitive systems, despite each of the eight systems having an impact rating of 'high' in one or more categories of confidentiality, integrity, and availability. Taxation's IT System and Data Classification Standard requires Taxation to classify a system as sensitive based on the highest classification of confidentiality, integrity, or availability of all data elements within the IT system. By not appropriately classifying these eight systems as sensitive, Taxation cannot ensure that it has the appropriate system classification information to develop its contingency planning and disaster recovery documentation, as well as the sensitivity of its systems and data.

- Taxation does not have approved SSPs for 35 of its 40 (87.5%) sensitive IT systems as required by Taxation's System Security Planning Standard and the Security Standard. Without an SSP for each sensitive IT system, Taxation cannot ensure that it has the necessary security and privacy controls in place to secure Taxation's sensitive IT systems and information.

- Taxation does not identify and document data types subject to regulatory requirements for each IT system as required by Taxation's System Security Planning Standard, the Security Standard, and the Data Classification Standard. Failure to identify and document data types subject to regulatory requirements could result in a failure to meet regulatory requirements, which may result in unauthorized data disclosure or fines.

- Taxation does not define and designate system-specific security roles, such as system owner, data owner, data custodian, and system administrator, for nine of its 40 (22.5%) sensitive IT systems as required by Taxation's System Security Planning Standard and the Security Standard. Failure to define and designate system-specific security roles could result in sensitive IT systems without assigned security roles and personnel, which could result in a lack of necessary IT controls and oversight in place over Taxation's sensitive IT systems and data.

Taxation completed a recent system inventory reorganization and failed to reclassify some systems as sensitive during the reorganization. Additionally, Taxation did not complete its ongoing project to identify and classify system data sets and complete all SSPs due to resource and time constraints, resulting in the identified weaknesses.

Taxation should evaluate and document within its Sensitivity Classification all data sets and the types of data within each set. Taxation should also classify all systems that have a rating of 'high' in one or more categories of confidentiality, integrity, and availability as sensitive and complete a risk assessment as necessary. Taxation should document and approve SSPs for the remaining 35 sensitive systems. As part of the process to document and approve SSPs, Taxation should identify and document data types subject to regulatory requirements and define and designate system-specific security roles for each system. Complying with its internal policies, the Security Standard, and Data Classification Standard will help Taxation protect the confidentiality, integrity, and availability of its sensitive and mission-critical IT systems and data.

RISK ALERT

During our audit, we encountered an issue that is beyond the corrective action of Taxation's management alone and requires the action and cooperation of management and the Virginia Information Technologies Agency (VITA). The following issue represents such a risk to Taxation and the Commonwealth.

Unpatched Software

First Reported: Fiscal Year 2015

VITA contracts with various providers, collectively known as the Commonwealth's Information Technology Infrastructure Services Program (ITISP), to provide agencies with installation, maintenance, operation, and support of IT infrastructure components, such as servers, routers, firewalls, and virtual private networks. Taxation continues to rely on contractors procured by VITA for the installation of security patches in systems that support Taxation's operations. Additionally, Taxation relies on VITA as the contract administrator to maintain oversight and enforce the contract agreements with the ITISP contractors. As of June 2025, the ITISP contractors had not applied a significant number of security patches that are critical and highly important to Taxation's IT infrastructure components, all of which are past the 30-day update window allowed by the Security Standard.

The Security Standard requires the installation of security-relevant software and firmware updates within 30 days of release or within a timeframe approved by VITA's Commonwealth Security and Risk Management division. The Security Standard does allow for varied timeframes depending on factors such as the criticality of the update, but generally the ITISP uses a 30-day window from the date of release as its standard for determining timely implementation of security patches. Missing system security updates increase the risk of successful cyberattack, exploit, and data breach by malicious parties.

While VITA is responsible for enforcing the service level agreement, it has not been able to compel the current ITISP contractors to install certain security patches to Taxation's IT infrastructure to remediate vulnerabilities in a timely manner or take actions to obtain these required services from another source. Taxation is working with VITA and the ITISP contractors to ensure that the ITISP contractors install all critical and highly important security patches on all servers. Our separate audit of VITA's contract management will also continue to report this issue.

RETAIL SALES AND USE TAX COLLECTION AND DISTRIBUTION

In accordance with § 30-133.2 of the Code of Virginia, we perform work related to retail sales and use tax distributions as part of our annual audit of Taxation. As a part of our initial review, we established a one-percent benchmark that Taxation should use to measure the effectiveness of the local sales and use tax distribution process. If the error rates exceed one percent, Taxation should perform additional analysis to determine the causes of the errors and whether further actions are required. Our audit included inquiries about the distribution and error processes and a review of the error rate to ensure Taxation distributed the local sales and use taxes within the established benchmark.

In fiscal year 2025, Taxation collected approximately $9.6 billion in retail sales and use taxes, with $1.9 billion of these revenues being distributed to localities as a one-percent local option tax. Taxation collects the tax and determines the local portion, which is distributed to the locality where the sale or activity occurred.

The sales and use tax distribution process requires a joint effort between Taxation, localities, and businesses. There are controls and processes in place to help ensure that locality distributions are accurate and made to the correct locality. When Taxation or localities detect a distribution error, they work together to research the error and, if necessary, Taxation processes an adjustment to correct the error and transfer the funds to the correct locality. Table 1 shows the local distribution amount for retail sales and use tax, as well as the amount and rate of distribution errors identified and corrected by Taxation in each of the last three fiscal years.

Error Rate for Local Sales Tax Distributions

Table 1

	2023	2024	2025
Local distribution amount	$1,770,841,651	$1,808,582,889	$1,876,912,588
Errors identified and corrected	2,646,637	1,801,527	2,852,188
Error rate	0.15%	0.10%	0.15%

Source: Taxation's financial accounting and reporting system

As shown above, the error rate for fiscal year 2025 was 0.15 percent. This error rate is within the one percent benchmark established, which indicates Taxation is properly distributing the local portion of the retail sales and use tax. We do not recommend any changes in the established benchmark or to Taxation's procedures for ensuring localities receive the correct distribution based on locality sales.

Commonwealth of Virginia

Auditor of Public Accounts

Staci A. Henshaw, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

December 15, 2025

The Honorable Glenn Youngkin
Governor of Virginia

Joint Legislative Audit
and Review Commission

Stephen E. Cummings
Secretary of Finance

James J. Alex
Tax Commissioner, Department of Taxation

We have audited the financial records and operations of the **Department of Taxation** (Taxation) for the year ended June 30, 2025. We conducted this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, in support of the Commonwealth's Annual Comprehensive Financial Report audit. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objective was to evaluate the accuracy of Taxation's financial transactions as reported in the Annual Comprehensive Financial Report for the Commonwealth of Virginia for the year ended June 30, 2025. In support of this objective, we evaluated the accuracy of recorded financial transactions in the Commonwealth's accounting and financial reporting system, Taxation's internal accounting and financial reporting system, and supplemental information and attachments submitted to the Department of Accounts (Accounts); reviewed the adequacy of Taxation's internal control; tested for compliance with applicable laws, regulations, contracts, and grant agreements; and reviewed corrective actions with respect to audit findings from prior reports.

Audit Scope and Methodology

Taxation's management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations, contracts, and grant agreements. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Financial reporting
Tax return processing
Tax revenue collections
Taxes receivable
Unearned taxes
Accounts payable and other liabilities
Tax abatements
Interest revenue
Taxation's accounting and financial reporting system
Information security and general system controls (including access controls)

We performed audit tests to determine whether the Taxation's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Taxation's operations. We performed analytical procedures, including budgetary and trend analyses, and tested details of transactions to achieve our audit objectives.

A nonstatistical sampling approach was used. Our samples were designed to support conclusions about our audit objectives. An appropriate sampling methodology was used to ensure the samples selected were representative of the population and provided sufficient, appropriate evidence. We identified specific attributes for testing each of the samples and, when appropriate, we projected our results to the population.

Our consideration of internal control over financial reporting (internal control) was for the limited purpose described in the section "Audit Objectives" and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control titled "Improve Tax Return Processing Reconciliation Controls," "Revoke Systems Access for Separated Employees in a Timely

Manner," "Develop and Implement a Third-Party Service Provider Oversight Process," "Improve Database Security," and "Improve IT Risk Management Program," which are described in the section titled "Internal Control and Compliance Findings and Recommendations," that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Conclusions

We found that Taxation properly stated, in all material respects, the amounts recorded and reported in the Commonwealth's accounting and financial reporting system, Taxation's internal accounting and financial reporting system, and supplemental information and attachments submitted to Accounts. The financial information presented in this report came directly from Taxation's internal accounting and financial reporting system.

We noted certain matters involving internal control and its operation and compliance with applicable laws, regulations, contracts, and grant agreements that require management's attention and corrective action. These matters are described in the section titled "Internal Control and Compliance Findings and Recommendations."

We determined Taxation has not completed corrective action with respect to the prior audit findings identified as ongoing in the Findings Summary included in the Appendix.

Since the findings noted above include those that have been identified as significant deficiencies, they will be reported as such in the "Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards," which is included in the Commonwealth of Virginia's Single Audit Report for the year ended June 30, 2025. The Single Audit Report will be available at www.apa.virginia.gov in February 2026.

Exit Conference and Report Distribution

We provided management with a draft of this report on January 15, 2026. Government Auditing Standards require the auditor to perform limited procedures on Taxation's response to the findings identified in our audit, which is included in the accompanying section titled "Agency Response." Taxation's response was not subjected to the other auditing procedures applied in the audit and, accordingly, we express no opinion on the response.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

Staci A. Henshaw
AUDITOR OF PUBLIC ACCOUNTS

SDB/vks

FINDINGS SUMMARY

Finding Title	Status of Corrective Action*	First Reported for Fiscal Year
Improve Tax Return Processing Reconciliation Controls	Ongoing	2025
Revoke Systems Access for Separated Employees in a Timely Manner	Ongoing	2023
Develop and Implement a Third-Party Service Provider Oversight Process	Ongoing	2023
Improve Database Security	Ongoing	2025
Improve IT Risk Management Program	Ongoing	2025

* A status of **Ongoing** indicates new and/or existing findings that require management's corrective action as of fiscal year end.

COMMONWEALTH of VIRGINIA

Department of Taxation

January 23, 2026

Ms. Staci A. Henshaw
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, VA 23219

Dear Ms. Henshaw:

The Department of Taxation ("Virginia Tax") has reviewed the findings and recommendations provided by the Auditor of Public Accounts from your audit of the agency's financial records and operations for the year ended June 30, 2025. I appreciate the professionalism of your staff and the performance of the audit and the opportunity to provide the following response.

Improve Tax Return Processing Reconciliation Controls

Virginia Tax has revised its return processing reconciliation procedures to minimize manual data entry errors and to ensure that any discrepancies are immediately researched and resolved. These procedures now include regular supervisor review. This corrective action plan is completed.

Revoke Systems Access for Separated Employees in a Timely Manner

Virginia Tax has revised the separation process to prevent delays in removing system access for separated employees. Additional preventative and detective controls have been implemented to ensure compliance with separation timeliness requirements. This process was implemented on January 1, 2026.

Develop and Implement a Third-Party Service Provider Oversight Process

Virginia Tax has developed and documented the process to identify, procure, maintain, and monitor external service providers. However, due to resources and time constraints, the process has not yet been fully implemented. We will continue our efforts to fully implement the process and train staff on the new policy and procedure, with an anticipated completion date of July 1, 2026.

Improve Database Security

Virginia Tax has implemented two of the three required security controls noted in the comment and will continue to work with VITA to develop a solution for implementing the remaining required security control. We anticipate completion by September 1, 2026.

Improve IT Risk Management

Virginia Tax is conducting data classifications for all of its systems in order to ensure that systems are appropriately classified with regards to sensitivity. This effort is anticipated to be completed by September 1, 2026. In addition, Virginia Tax is actively converting all SSP's to VITA's new template following the implementation of the updated format. Sensitive systems will be prioritized, followed by non-sensitive systems. System sensitivity classifications, data types, and system-specific security roles will be redefined using the new template to ensure alignment across Virginia Tax's IT Risk Management Program. The anticipated completion date of this project is June 1, 2027.

Risk Alert - Unpatched Software

As your report documents, Virginia Information Technologies Agency (VITA) is responsible for ensuring this Risk Alert is corrected. Virginia Tax will continue to assist VITA where possible regarding this issue.

If you or your staff have any questions, please contact me at 804-786-3332.

Sincerely,

Kristin L. Collins
Tax Commissioner
Commonwealth of Virginia

C: The Honorable Mark D. Sickles, Secretary of Finance