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INTERNAL AUDIT REPORT

Alcohol Licensing

2026

City of Sioux Falls Internal Audit Department Carnegie
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Introduction

The Alcohol Licensing Audit was included as a special audit request on the Three-Year Audit Plan. The purpose of the audit was to review the processes and key controls utilized by the City when accepting and processing Alcohol Licenses. The audit assessed whether internal controls are designed and operating effectively to support compliance with applicable laws and regulations, accurate fee assessment and collection, and appropriate oversight of licensing activities.

Background

Each year, the City of Sioux Falls receives alcohol license applications from local business owners, including several different types of both new and renewal permits. Each application follows the steps in the process below before being presented to the City Council for consideration and approval:

- Preliminary checklist
- State Application Form completion – Uniform Beverage application
- Application Fee payment
- Submission of application and fee uploaded into EnerGov by the Licensing Specialist
- Licensing Specialist prepares Memo for City Council review
- Documentation submission to city clerk

Timeline from initial application to City Council review is typically four to six weeks. Applicants are not required to attend the City Council meeting to be approved unless council members have specific questions, in which case, the applicant is notified of the date and time along with questions prior to the meeting by the Licensing Specialist. The licensing specialist is a member of the City Attorney's office, who then regularly consults with an assigned Senior Assistant City Attorney for a determination of all legal issues. Together, they form the City's "Licensing team."

For alcohol license regulations, the state of South Dakota determines the rules and laws that should be followed by municipalities in the state. The state preempts local control for the alcohol license application process and is responsible for the legislation and enforcement of state regulations. This responsibility includes all state prescribed forms and requirements for the license application process.

The fee structure for alcohol licenses includes:

1. Initial fees and or renewal fees (depending on application)
2. Fire inspection fees

Liquor licenses require initial fees which vary depending on the type of license. Initial license fees are determined by sealed bid (minimum \$240,646 based on population) for on-sale liquor dealers where lower license fees would be in effect for off-sale or one-day licenses. Other fees include an annual renewal fee of \$1,500, a \$10 publication fee, and a \$23 fire inspection fee. Beer and wine licenses have lower initial fees, with beer at \$300 and wine at \$500 for both initial and renewal fees.

The fees remain in the City's general fund with the exception of malt beverage license fees that are split 50/50 between the City and the State, including both initial and renewal fees.

All fees are recorded in the EnerGov system, which tracks the license name and associated fee. The system is used exclusively for financial tracking, while other databases (GIS) are used for license management.

Fines related to alcohol licensing are handled by both the State and the City, including city-imposed fees such as a \$20 returned check fee for insufficient funds payments.

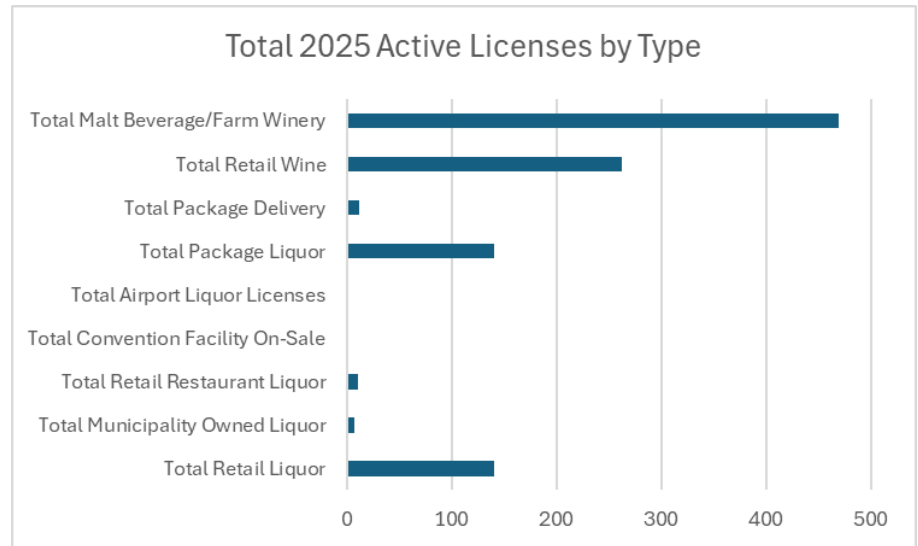
Complaint handling and license enforcement procedures were evaluated to understand complaint handling, including investigation steps, involvement of the city attorney and police, communication with the State, and the City Council's role in renewal decisions based on documented violations.

Internal Audit reviewed a sample of complaints to verify that each complaint was processed in compliance with applicable procedures.

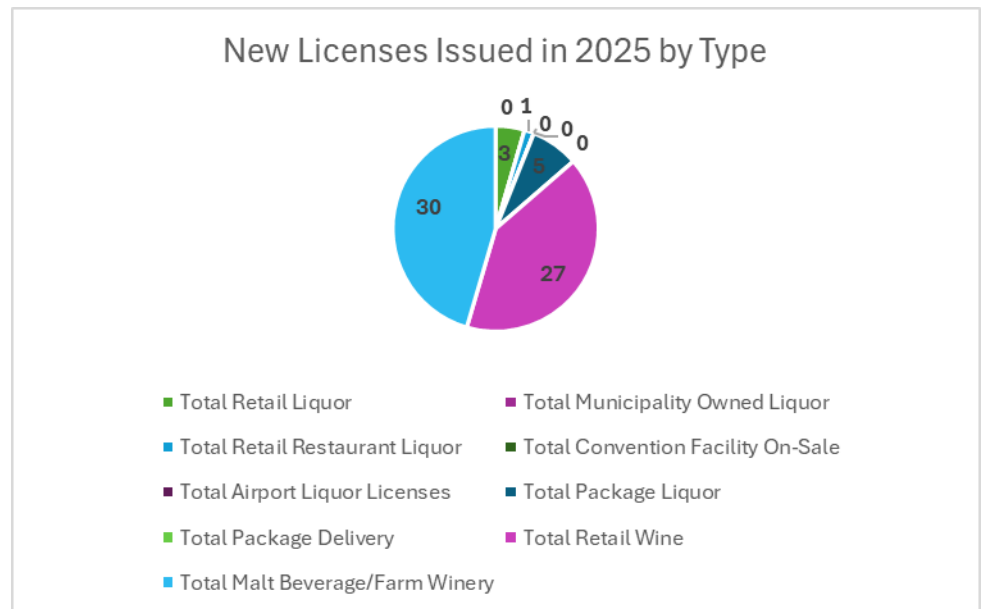
A sample of approved licenses was randomly selected for testing to validate the approval process. This included verifying applications were completed, applications were appropriately approved, licenses were issued and license fees were properly charged and recorded. No issues were found in sample testing.

A sample of applicant background checks was requested, however, after discussion with the Licensing Specialist, background checks are not conducted by the Licensing Specialist within the City Attorney's office. Applicants self-disclose felony convictions on the application. Any felony conviction is an automatic disqualifier for holding a liquor license in the state of South Dakota. However, state law does not require a background check as part of the license application process. Based on discussions with the City Attorney's office, the City is not legally able to perform criminal background checks on license applicants.

Total active alcohol licenses for 2025 were 1,046.



The City issued 66 new licenses in 2025.



Based on sample testing, we found that department personnel appear to be following procedures for license approvals, receipt of fees and recording, and complaint handling.

Objective

To determine if the City issues and renews alcohol licenses in accordance with applicable requirements; accurately assesses, records, and monitors licensing related fees; maintains documentation sufficient to support oversight and accountability; and appropriately monitors complaints and enforcement actions related to alcohol licenses.

Scope

The audit scope included a review of the current processes utilized by the City Attorney's office when obtaining new and renewal applications, applicable fee assessment and recording, complaint handling and communication with the City Council and State.

Methodology

The audit procedures included interviews with City personnel, review of processes described by management, and evaluation of control design and operating effectiveness.

Results

Policies and Procedures

Based on a review of policies and procedures related to the alcohol licensing process, Internal Audit noted that a number of policies contained no evidence of recent reviews.

Finding 1: Policies and procedures should be formally approved and reviewed regularly.

The City Licensing team annually reviews all the City's alcohol licensing policies and procedures after the South Dakota Legislature's annual Legislative Session has concluded. This review analyzes current City ordinances and policies (including state-prescribed application forms) to ensure the City will remain in full compliance with any new state laws or regulations. If changes are needed at the City level, then the City Licensing team will alert the City's elected officials and draft proposed ordinance changes to comply with state law requirements. Those ordinance changes are timed to coincide with any new state laws that take effect on July 1 of that calendar year. There was no evidence of recent reviews or updates being made to the procedures reviewed. However, a number of procedures were in the process of being updated based on discussion with City personnel.

Policies and procedures should be reviewed regularly and updated as needed. Each policy document should include an effective date, as well as a date of last review to evidence that the policy is current.

See recommendation 1.

Opportunity For Improvement

Opportunity 1: Applicant Eligibility.

Control activities do not include independent verification to prevent or detect ineligible applicants from being licensed. This includes no background checks to verify if any felonies exist for the applicant,

which is an automatic denial of a license. South Dakota state law prohibits individuals with a felony from holding an alcohol license and the state requires applicants to disclose any felony convictions during the application process. However, the City of Sioux Falls does not have legal authorization to perform a criminal background check on its own for any applicant. The City relies on the collective knowledge and experience of its Police Department for any possible concerns with applicants or license holders. The Sioux Falls Police Chief is provided with a list of applicants for alcohol licenses, along with the City Council.

See recommendation for opportunity 1.

Opportunity 2: System reconciliation.

Control activities do not include periodic reconciliations between the public licensing records and EnerGov.

See recommendation for opportunity 2.

Recommendations and Management Response

- 1 While the City relies on established procedures and applicable state laws, we recommend the formalization and approval of comprehensive policies, including a defined process for periodic review and updates. Policies and procedures should be reviewed at least annually, updated as necessary, and include both an effective date and a date of last review to support consistent and compliant execution of licensing, renewal, fee processing, complaint handling, and City Council communication activities.

Management's Response: The City has a formal process of tracking and monitoring any municipality-related state legislation during each SD Legislative Session. The City Licensing team is part of that overall process for any state legislation related to alcohol licensing. After the annual SD Legislative Session has concluded in March, the City Licensing team reviews the City's alcohol licensing policies, including the state-prescribed application forms, to ensure the City will be able to comply with any new laws or regulations. If changes are needed at the City level to match upcoming changes at the state level, then the City Licensing team will alert the City's elected officials and draft proposed ordinance changes to comply with those state law changes when those become effective. Management Representative Responding: City Licensing team.

Date of expected implementation: On-going.

Opportunity for Improvement

- 1 We recommend considering whether compensating controls are needed at the local level as it relates to verifying applicants do not have disqualifying felony convictions to prevent the issuance of alcohol licenses to ineligible applicants. This should include the consideration of state regulations and related restrictions, where applicable.

Management's Response: The City would need express authorization from the State to conduct criminal background checks on applicants and license holders.

Management Representative Responding: City Licensing team.

Date of expected implementation: N/A.

- 2 We recommend establishing and documenting a periodic reconciliation between licensing records and the EnerGov system to ensure the completeness and accuracy of licensing and fee information. This process should include (1) identifying authoritative data sources for licensing activity, (2) performing a comparison of key data elements (e.g., license type, status, fees assessed and collected), (3) investigating and resolving identified variances in a timely manner, and (4) retaining documentation evidencing the reconciliation and resolution of discrepancies. The reconciliation should be performed on a defined periodic basis and reviewed by appropriate supervisory personnel.

Management's Response: The City Licensing team undergoes a bi-annual reconciliation with the licensing records on the EnerGov system and the licensing records held by the State Department of Revenue to ensure the State and the City have the same exact list of license holders, including all pertinent information. The City could add a layer of internal control to

this process by having another City officer located in the City's Department of Finance review this same list on at least an annual basis, including any licensing and fee information.

Management Representative Responding: City Licensing team

Date of expected implementation: 6/30/2026

Conclusion

The City has established processes to administer alcohol licensing activities; however, several internal controls are not adequately designed or documented to ensure consistent execution, effective monitoring, and sufficient oversight.

Authorization

The Sioux Falls City Council approved this audit by resolution and was included as a Special Request Audit in the Three-Year Audit Plan. The Internal Audit Division operates under the authority of Sections 32.010 through 32.025 of the Sioux Falls Code of Ordinances.

Statement of Independence

Internal Audit is administratively and operationally independent of the programs and departments it audits, both in appearance and in fact. The Internal Audit Manager is accountable to an Audit Committee appointed by the City Council per Section 32.022 of the Code of Ordinances of Sioux Falls, SD.

Distribution of Report

This report is intended for the information and use of the Mayor and City Council, management, and others within the City of Sioux Falls. However, the report is a matter of public record, and its distribution is not limited.

Performed By

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