



# The Importance of Internal Controls in Managing Federal Grants

This quick guide explains the critical role of **internal controls** in the management of federal grants. It outlines the requirements under the **Uniform Guidance (2 CFR Part 200)** and highlights how strong internal controls ensure compliance, prevent fraud, and support successful program outcomes.

## Safeguarding Federal Funds Through Effective Oversight and Accountability

Publish Date	DATE
Background	<p>Internal controls serve as a framework for organizations to achieve their objectives, while complying with federal statutes, regulations, and the terms and conditions of the award (2 CFR 200.303(a)). The absence of internal controls can have serious legal, financial, reputational, and operational consequences for both the recipient and responsible individuals involved in the management of the grant. Federal grant recipients are stewards of public funds and are required to implement internal controls that ensure proper use, reporting, and the safeguarding of those funds.</p> <p>The <b>Uniform Guidance</b> (<a href="#">2 CFR § 200.303</a>) mandates that non-federal entities establish and maintain effective internal control systems that align with widely accepted frameworks such as the <a href="#">Green Book</a> (GAO Standards for Internal Control in the Federal Government) issued by the Comptroller General of the United States or <a href="#">COSO</a> (Committee of Sponsoring Organizations of the Treadway Commission).</p> <ul style="list-style-type: none"><li>• <b>Green Book</b> - Established in 1983, provides a framework for designing, implementing, and operating an effective internal control system. The Green Book explains the relationship that exists between an entity's objectives, the five components of internal control and an entity's organizational structure.</li><li>• <b>Committee of Sponsoring Organizations of the Treadway Commission (COSO)</b> - A joint initiative of five private sector organizations whose mission is to provide thought leadership through the development of frameworks and guidance on enterprise risk management, internal control, and fraud deterrence.</li></ul>

## Key Components

Internal controls are not just a compliance requirement, they are essential for risk management, program integrity, and financial accountability. See also, “*Establishing and Maintaining Internal Controls*” and “*Components of Internal Controls*” backgrounders in the Center for Grants Excellence.

### A. Definition and Purpose of Internal Controls

An “Internal Control is a process effected by an entity’s oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved” (Green Book OV1.01). The book organizes objectives into one or more of the following categories:

- Operations (effectiveness and efficiency)
- Reporting (reliability and timeliness)
- Compliance (with laws and regulations)

### B. Core Components of Internal Control Systems

There are five components of effectively designed and implemented internal controls framework of which are defined in the Standards for Internal Control developed by GAO and referred to as the “Green Book” as well as the COSO Internal Control - Integrated Framework.

The five components are:

1. **Control Environment** - Establishes the foundation for an internal control system emphasizing integrity and ethical values. The control environment provides the discipline and structure to help an entity achieve its objectives (Green Book OV2.04) ensuring the non-federal entity has clear goals, objectives, and systems in place. The control environment should be implemented from the top down, assigning responsibility and delegation of authority with appropriate segregation of duties to ensure the objectives of the organization are met. Documentation must be maintained as “evidence that controls are identified, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated by the entity” (Green Book OV3.10).
2. **Risk Assessment** - Involves identifying and analyzing risks, assessing the probability of occurrence, and understanding potential consequences that could impede the achievement of an entities’ objectives. Objectives must be defined “in specific and measurable terms to enable the design of internal control for related risks” (Green Book OV6.02) Risk assessments must be conducted periodically and throughout the life of the program to ensure consideration of changes in objectives, control environment, or of factors such as federal policy updates or audit findings.
3. **Control Activities** - Refers to the policies and procedures needed to achieve objectives and mitigate risks. Control activities can be an organization’s guide in responding to risks, **detecting risk** or uncovering a problem or potential problem after it has occurred, and **preventing risk by** protecting against errors or irregularities from occurring. Management is expected to document “policies and procedures for each unit within the entity’s organizational structure, its responsibility for a business process’s objectives and related risks and control activity design, implementation, and operating effectiveness” (Green Book OV12.03). Policies and procedures must be

## Understanding the Impact

reviewed periodically to ensure “continued relevance and effectiveness in achieving the entity’s objectives or mitigating related risks” (Green Book OV 12.05).

4. **Information and Communication** - Includes the timely identification and communication of requirements, responsibilities and expectations using relevant and reliable data and sources of information in support of the internal control system. Information requirements must consider the needs of both internal and external stakeholders (Green Book OV13.02). As objectives and risk change, adjustments to information and communication requirements may be necessary. “Management obtains relevant data through a variety of forms, including using manual input or compilation, using information technology, or coordinating with other entities to obtain or access data. Sources of data can be operational, reporting, or compliance related” (Green Book OV12.04).
5. **Monitoring Activities** - Involves the evaluation of the five components of internal control, including controls to affect the principles within each component, is present and functioning or if change is needed” (Green Book OV16.01) an entity conducts monitoring activities to evaluate the internal control system. “Ongoing monitoring includes regular management and supervisory activities, comparisons, reconciliations, trend analysis, data analytics, activities to identify improper payments or potential fraud, testing, and other routine actions” (Green Book OV16.05). It is through monitoring practices that weaknesses, risks, and course corrections are found resulting in corrective action or changes in the internal control system.

### C. Internal Controls Required by Uniform Guidance ([2 CFR 200.303](#))

The Uniform Guidance, specifically 2 CFR 200.303, requires non-Federal entities that receive Federal awards to establish and maintain effective internal control over those awards. This is to ensure compliance with applicable Federal statutes, regulations, and award terms and conditions. Some recommendations for strengthening internal controls are:

- Segregation of duties
- Written policies and procedures
- Subrecipient monitoring
- Procurement controls
- Timely and accurate financial reporting
- Safeguarding of assets

#### For Recipients:

- A lack of strong internal controls increases the risk of noncompliance, questioned costs, and audit findings.
- Without proper internal controls organizations run the risk of inaccurate reporting, inefficient operations, and even in some cases, unethical stewardship of funds.
- Causes a compliance failure with 2 CFR 200 Uniform Guidance.
- Not implementing internal controls, organizations demonstrate a lack of commitment to the proper management of Federal awards.

#### For Federal Agencies:

## Next Steps & Recommendations

- Federal agencies must emphasize the importance of internal controls at the recipient level. Internal controls are essential for program success and accountability.
  - Federal agencies must have robust internal controls at the program level to minimize the risk of intentional misconduct or accidental errors in awarding, administering, and/or closing out grants.
  - Federal agencies are stewards of public resources, if there is a lack of internal controls, agencies run risk of fulfilling their fiduciary, legal, and ethical responsibility to manage federal financial assistance.
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- **Engage senior leadership** in review of internal controls. Management is responsible for creating a control environment that emphasizes integrity, ethical values, and communicating to staff their responsibilities related to internal controls.
  - **Conduct an internal control assessment** with financial and programmatic staff using the Green Book or COSO framework.
  - **Document policies and procedures** for all grant-related activities.
  - **Train staff** on internal control responsibilities and fraud prevention.
  - **Establish a monitoring plan** for subrecipients (if applicable) and contractors.

## Additional Resources

- [2 CFR § 200.303 – Internal Controls](#)
- [GAO Green Book – Standards for Internal Control in the Federal Government](#)
- [COSO – Internal Control Framework](#)
- [GFOA – Internal Controls for Grants](#)

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