Center for Grant EXCELLENCE

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Components of Internal Controls

This quick guide explains key principles for establishing internal controls. By implementing these principles into an internal control framework, organizations can improve operational efficiency, strengthen accountability, and ensure the responsible stewardship of federal funds by protecting against fraud, waste, and abuse.

Principles of an Effective Internal Control Framework

Publish Date	**DATE**
Background	As a recipient of federal funding, entities are obligated to adhere to the internal control requirements defined in the Uniform Guidance (2 CFR § 200.303). The U.S. Government Accountability Office's (GAO)'s "Green Book" and the Committee of Sponsoring Organization's (COSO) Internal Control – Integrated Framework outlines 5 components and 17 principles for establishing effective internal controls. The *"Establishing and Maintaining Internal Controls"* and "*Importance of Internal Controls*" backgrounders cover other aspects of internal controls.

Key Components	**A. Five Key Components of Effective Internal Controls**
	
	1. Control Environment
	2. Risk Assessment
	3. Control Activities
	4. Information and Communication
	5. Monitoring Activities
	
	B. Key Principles of Effective Internal Controls
	
	1. **Control Environment**
	   a. The organization demonstrates a commitment to integrity and ethical values.
	   b. The board of directors demonstrates independence from management and exercises oversight.

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      c. Management establishes structures, reporting lines, authorities, responsibilities.

      d. The organization demonstrates a commitment to attract, develop, and retain competent individuals.

      e. The organization holds individuals accountable for their internal control responsibilities.

2. Risk Assessment

      a. The organization specifies objectives with sufficient clarity to identify risks.

      b. The organization identifies and analyzes risks to the achievement of objectives.

      c. The organization considers the potential for fraud in assessing risks.

      d. The organization identifies and assesses changes that could significantly impact internal control.

3. Control Activities

      a. The organization selects and develops control activities that mitigate risks.

      b. The organization selects and develops general controls over technology.

      c. The organization deploys control activities through policies and procedures.

4. Information and Communication

      a. The organization obtains or generates and uses relevant, quality information.

      b. The organization internally communicates information to support internal control.

      c. The organization communicates with external parties regarding internal control matters.

5. Monitoring Activities

      a. The organization selects, develops, and performs ongoing or separate evaluations.

      b. The organization evaluates and communicates internal control deficiencies in a timely manner.

Case Study: In the *Office of Justice Program Territories Financial Support Center* (OJP TFSC) G*uide Sheet*, the Department of Justice (DOJ) provides examples of common types of grant fraud, waste, abuse and mismanagement.

In one example, DOJ outlines an instance of a "nonprofit entity that received $2.7 million in federal award funds to assist underprivileged children. However, it was discovered that they had used the funds to pay for a wedding reception, building construction, a plasma TV, and personal credit card bill with an estimated total loss of $450,000. This scheme resulted in a 36- and 66- month sentence and full restitution" (OJP TFSC Guide Sheet). Additional case studies, ways to reduce waste, fraud, and abuse, and supplementary resources are included in the OJP guide sheet.

Examples of Internal Control Activities:

1. Control Environment
- Update or reinforce codes of conduct and conflict of interest policies.
- Provide regular training on internal controls and grant compliance.
- Reaffirm leadership's commitment to ethical conduct and compliance.

2. Risk Assessment
- Identify high-risk areas (e.g., subrecipient monitoring, procurement).
- Develop mitigation strategies and document them in a risk register.
- Conduct a formal risk assessment specific to grant activities.

3. Control Activities
- Ensure segregation of duties in financial and programmatic functions.
- Implement checklists or approval workflows for key transactions.
- Review and update policies and procedures for grant-related processes.

4. Information and Communication
- Ensure timely dissemination of policy changes and compliance alerts.
- Use dashboards or reports to share performance and compliance data.
- Establish clear communication channels for grant-related updates.

5. Monitoring Activities
- Track corrective actions from prior audits or monitoring visits.
- Use performance metrics to evaluate the program and financial status.
- Schedule periodic internal reviews or audits of grant activities.

Understanding the Impact

Comprehensive and effective internal controls are both required and impactful. An entity must establish an internal control system to demonstrate fiscal and programmatic accountability and responsibility. Lack of internal controls or insufficient implementation and design of an internal control system may lead to fraudulent activities such as misuse, fraud, waste, and abuse.

Some common types of grant fraud include:

- Conflicts of Interest
- Failure to properly support the use of funds
- Embezzlement
- Fraud
- Waste
- Abuse
- Mismanagement

Next Steps & Recommendations

- Document all policies, procedures, workflows, staff roles and responsibilities, strategies, goals, and objectives.

- Regularly examine existing policies and procedures for weaknesses and vulnerabilities.

- Provide timely and routine training for staff on internal controls, policies and procedures, systems, and regulatory changes.

- Define a mechanism for the confidential reporting of fraud, waste, and abuse.

- Collaborate and communicate across business functions to ensure clear communication and transparency between fiscal, programmatic, compliance, and management teams.
- Leverage technology where possible to automate, track, and manage the internal control system.

Additional Resources

- eCFR: 2 CFR 200.303 -- Internal controls.
- Implementing the COSO Integrated Framework
- eCFR: 2 CFR 200.303 -- Internal controls.
- USDOJ OJP Guide Sheet
- GAO Standards for Internal Controls
- DOJ Grants Financial Guide 2024 | Welcome to the DOJ Grants Financial Guide | Office of Justice Programs
- Internal Control for Grants – Government Finance Officers Association
- Office of Inspector General US Department of Housing and Urban Development, Integrity Bulletin

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