Establishing and Maintaining Internal Controls

Organizations that receive federal funding are required to establish and maintain effective internal controls in accordance with 2 CFR 200.303. This quick guide explains how Internal Controls are essential to ensure compliance with federal regulations, effectively manage risk, and prevent and detect fraud, waste, and abuse of federal funds.

By implementing a strong internal control framework, organizations can improve operational efficiency, strengthen accountability, and ensure the responsible stewardship of federal funds. This document is designed to guide organizations in developing, implementing, and sustaining effective internal controls.

Framework for Internal Controls Implementation & Sustainability

Publish Date	**August 1, 2025**
Background	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)). 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. Each component is based on 17 principles designed to provide a framework entities can leverage to establish and achieve effective internal controls. It is a condition of award for grant recipients to have internal controls in place.
Key Components	An internal control framework should be organized into five components, each with specific principles that guide effective management and governance: • **Control Environment**: Establishes the foundation for internal control, emphasizing integrity and ethical values.

- **Risk Assessment:** Involves identifying and analyzing risks that could impede the achievement of objectives.

- **Control Activities**: Refers to the policies and procedures that ensure objectives are met and risks are mitigated.

- **Information and Communication:** Ensures relevant information is effectively communicated in a timely manner across the organization.

- **Monitoring Activities**: Involves ongoing evaluations of the internal control system to ensure its effectiveness and quality of performance.

Examples:

Below are some examples of activities that may be useful in creating internal controls:

- Establish a process for resolving ethical issues/questions.
- Establish procurement policies and procedures.
- Develop a pre-approval workflow for grant expenditures.
- Conduct regular budget reviews and reconciliations according to policies and procedures.
- Conduct formal training on all components of the internal control system.
- Ensure segregation of duties across various workflows.
- Establish a Conflict-of-Interest policy
- Provide a mechanism for confidential disclosure of suspected fraud, waste, or abuse with whistleblower protections

Understanding the Impact

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. Some key implications include:

- Increased risk of fraud, waste and abuse making programs vulnerable to ineligible spending, misappropriation, unauthorized use of funds, or embezzlement.

- Loss of Funding or grant termination by the funder for failure to comply with grant terms and conditions and poor stewardship of funds.

- Audit findings and repayment obligations may result in the repayment of disallowed costs, increased scrutiny, and corrective actions.

- Civil or criminal liability resulting in civil penalties or False Claims Act violations, criminal prosecution for fraud or theft, or personal liability for senior leadership or grant managers.

- Reputational damage may occur in the form of increased challenges in obtaining future grant funding, loss of trust from funders and partners, along with negative media attention and increased scrutiny by leaders and stakeholders.

Case Study: The Head Start Program Embezzlement (Texas, 2014)

What Happened: An executive director of a nonprofit administering federal Head Start funds embezzled over $1 million over several years. She diverted funds for personal use, including luxury items, home renovations, and travel.

Key Failures:

- Lack of segregation of duties

- Board of directors failed to perform oversight

- Poor documentation and absence of independent audit

Internal Controls That Could Have Prevented It:

- Strong financial oversight by the board

- Routine internal and external audits

- Dual signatories required for large expenditures

- Segregation of duties (e.g., separate roles for procurement, approval, and disbursement)

U.S. Department of Justice (Northern District of Texas) press release: *"Former Executive with Non-Profit that Provides Head Start Services in Dallas Admits to Embezzlement Scheme"*, dated December 1, 2016, describing how Evetta Galloway Griffin admitted to embezzling federal Head Start grant funds in excess of $1 million intended for services in the Dallas area.

Next Steps & Recommendations

To implement effective internal controls, organizations should take the following steps:

- **Establish a Control Environment:** Build a foundation of integrity, ethical values, and competence by setting standards and expectations that support a culture of accountability and compliance throughout the organization.

- **Conduct Risk Assessments:** Identify and evaluate potential risks that could impact grant compliance or performance. This includes assessing both internal and external factors that may hinder the achievement of grant objectives.

- **Develop Control Activities:** Design and implement policies, procedures, and practices that mitigate identified risks. These activities should be integrated into daily operations and tailored to the specific requirements of each grant.

- **Ensure Information and Communication:** Maintain effective channels for sharing relevant, timely, and accurate information across all levels of the organization. This supports informed decision-making and ensures that all stakeholders understand their roles in the grants process.

- **Monitor Internal Controls:** Regularly evaluate the effectiveness of internal controls and communicate any deficiencies to responsible parties for corrective action.

Additional Resources

- eCFR: 2 CFR Part 200 -- Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards
- COSO Internal Control – Integrated Framework Principles
- GAO "Green Book"
- Grant Fraud Responsibilities | Grants.gov
- eCFR: 2 CFR 200.303 -- Internal controls.
- USDOJ OJP Guide Sheet

- GAO-14-704G, STANDARDS FOR INTERNAL CONTROL IN THE FEDERAL GOVERNMENT
- DOJ Grants Financial Guide 2024 | Welcome to the DOJ Grants Financial Guide | Office of Justice Programs
- Government Finance Officers Association
- Northern District of Texas | Former Executive with Non-Profit that Provides Head Start Services in Dallas Admits to Embezzlement Scheme | United States Department of Justice

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