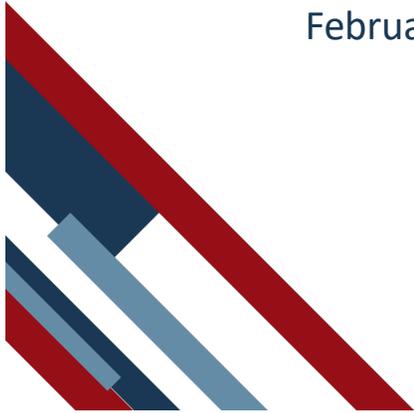# Internal Controls 101

Texas Association of Regional Councils

February 2026

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Learning Objectives

- A general overview of internal controls and how they work with grant management.
- Review required policies and procedures and how to develop ones that are federally compliant.
- Overview of recordkeeping requirements.
- Introduction to the Single Audit and preparation tips.

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Part 1: What Are Internal Controls?

What Are Internal Controls?

To ensure compliance with federal regulations and receive grant funding, an organization must develop policies (how), processes (what), and procedures (what and when)..

THESE ARE INTERNAL CONTROLS

Internal Controls
- Set a culture of compliance
- Identify threats to compliance
- Put procedures in place and train staff
- Communicate risk
- Monitor for compliance

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Why Are Internal Controls Important?

1 Internal controls reduce risks that could prevent an organization from achieving its goals and objectives.

2 In grants, main risks include non-performance by recipients, subrecipients, or contractors.

3 Federal agencies focus on minimizing recipient (your organization) risk. Defined internal controls, segregation of duties, and strong past performance demonstrate reliability which are key for funding eligibility.

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Federal Agency Responsibilities

Federal funding agencies evaluate the applicant's risk profile and ethical culture (control environment) to prevent waste, fraud, and abuse.

Ways to assess risk with a risk framework Key elements in a federal risk framework (§ 200.206)?

- Financial stability

- Quality of management systems

- History of performance

- Previous audit reports and findings

- Ability to effectively implement the program

Managing Organizational Risk

Financial — Operational — Regulatory (Compliance) — Reputational — Strategic
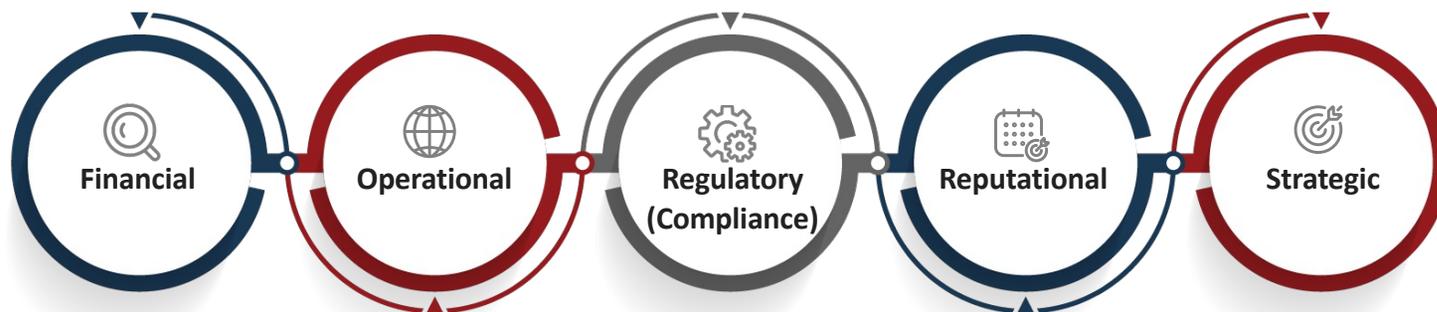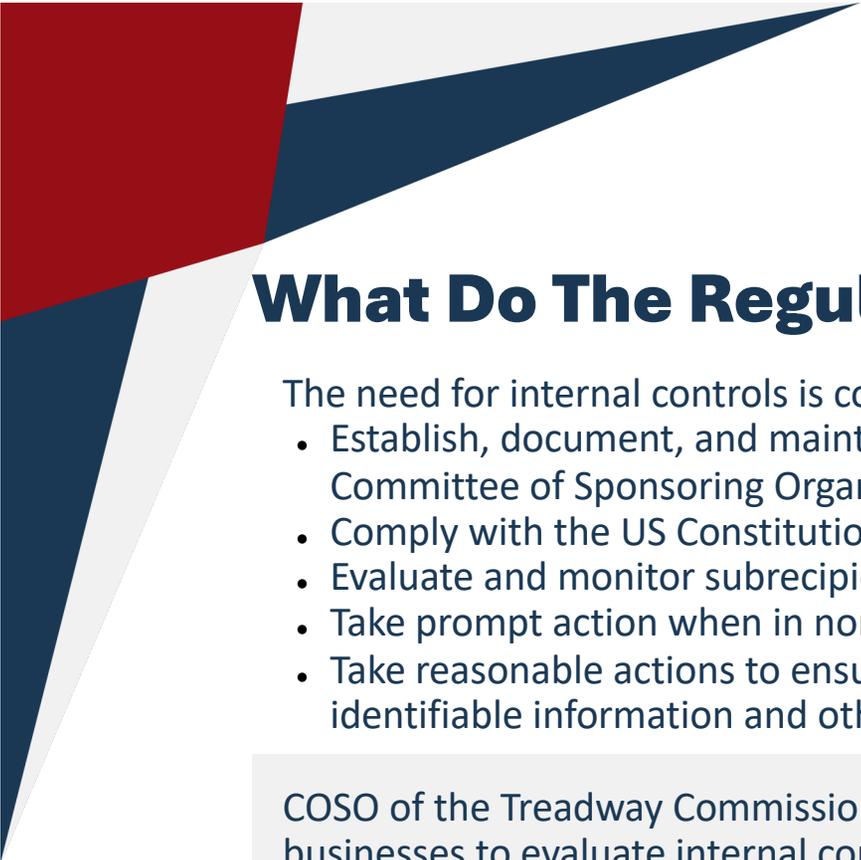
What Do The Regulations Say And Who Is COSO?

The need for internal controls is codified 2 CFR 200.303. Specifically, a grant recipient must:
- Establish, document, and maintain effective internal controls as defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)
- Comply with the US Constitutions and federal regulations
- Evaluate and monitor subrecipient compliance
- Take prompt action when in noncompliance
- Take reasonable actions to ensure cybersecurity and safeguard protected personally identifiable information and other types of information

COSO of the Treadway Commission is an organization that develops guidelines for businesses to evaluate internal controls, risk management, and fraud deterrence.

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Source: https://www.i-sight.com/resources/coso-framework-what-it-is-and-how-to-use-it/

The COSO Rubik's Cube

COSO designed the internal controls Rubik's cube

- How do all these pieces fit together?
- How do they fit into the world of federal grants?
- How can you make them fit into your organization?

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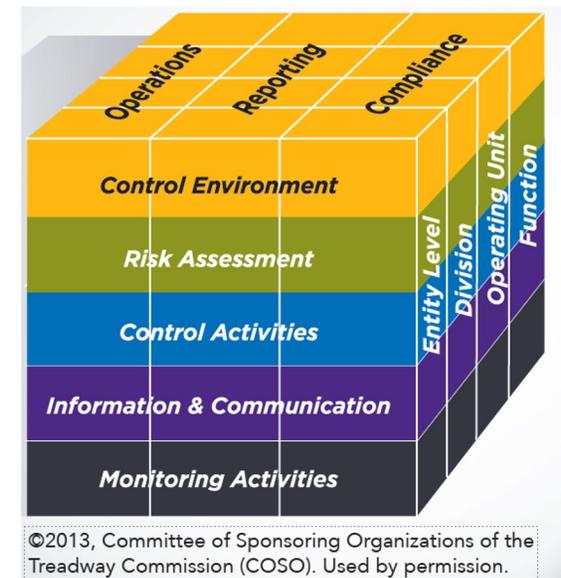
Seven Main Components of COSO

1 **Separation of duties**: Breaks down tasks so no one person can complete a transaction alone, providing built-in checks and balances.

2 **Policies and procedures**: Written guidance on planning, organizing, directing, controlling, and reporting on organizational operations; available to staff with regular training.

3 **Documentation**: Maintain clear, accurate records to support and verify program activities.

**4** **Authorization**: Establishes transactions that should be reviewed and authorized before execution.

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Seven Main Components of COSO

5 **Asset safeguarding**: Physical assets susceptible to misappropriation or misuse, such as cash and fixed assets, are properly secured and accessible only to authorized personnel.

6 **Reconciliations**: Accounting reconciliations corroborate that recorded transactions are accurate and provide the most current information for reporting. Physical reconciliations ensure assets purchased with program funds are being properly utilized.

7 **Monitoring:** Ensure adequate oversight of internal application of 2 CFR 200 and oversight of external partnerships.

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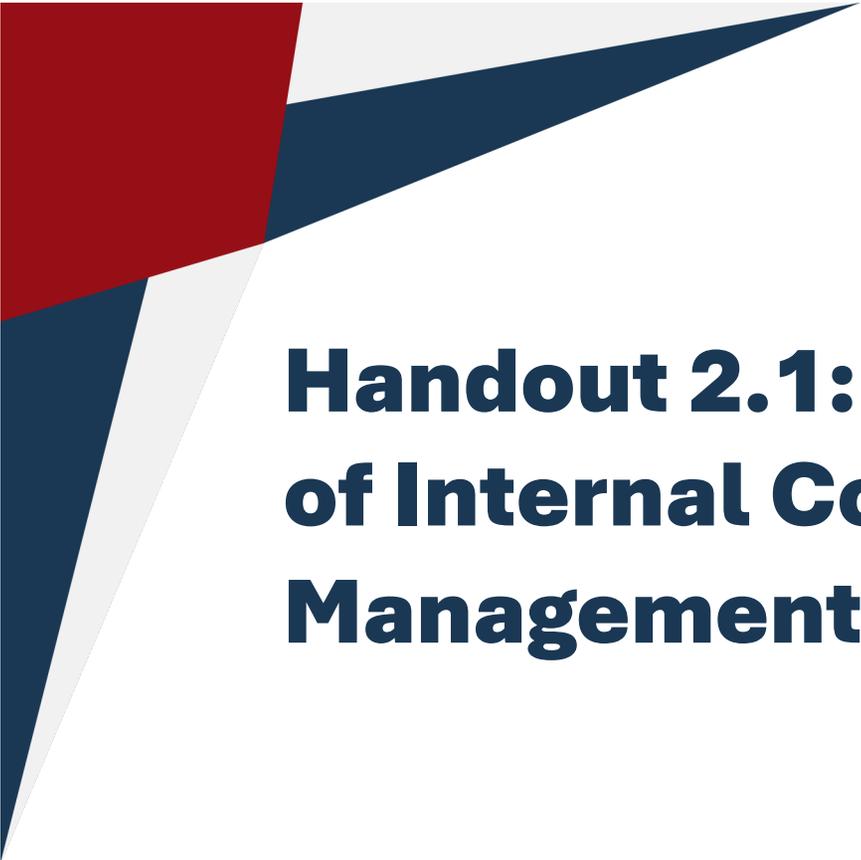
Handout 2.1: 7 Main Components of Internal Controls in Grant Management
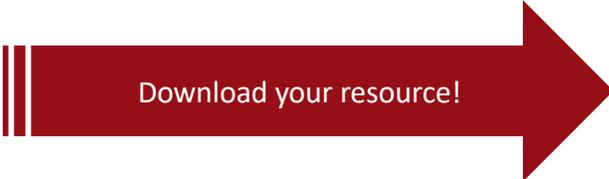
Download your resource!

Internal Controls and Opportunities

- Conduct a go-no-go assessment on pursuing a grant opportunity **(how will it impact my organization?)**

- Determine whether to partner with subrecipients and contractors **(will these be good partners?)**

- Conduct activities to minimize potential disallowed costs, waste, fraud and abuse of funds

Segregation of Duties

Internal controls require adequate segregation of duties (SOD).

Prevent problems by **NOT** having one person responsible for:

- Custody
- Recordkeeping
- Authorization

Demonstrate segregation with:

- Review of reports
- Custody of assets
- Authorization process

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What Does This Look Like In Practice?

Payment Processes - Small Organization

Process

1. **Grant Manager** prepares payment request and supporting documentation.
2. **Executive Director** reviews and approves payment.
3. **Bookkeeper (or outsourced accountant)** enters the payment into the accounting system and processes.

Common Challenges

1. One person handling several steps can create a greater risk for error.
2. Bandwidth issues for staff to adhere to full federal reporting requirements.
3. Processes may be less automated, rely of paper-based logs.

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What Does This Look Like In Practice?

Payment Processes - Medium Organization

Process

1. **Program Officer** confirms deliverables have been met and initiates the payment request.
2. **Grants Finance Officer** reviews supporting documents for compliance with grant terms and budget.
3. **Finance Director** approves disbursement and authorizes payment.
4. **Accounts Payable Clerk** processes the payment in the accounting system.

Common Challenges

1. Staffing not scaled to manage higher volume.
2. Systems may be not be fully integrated which can lead to issues when data is transferred.
3. Policies exist but may not be consistently applied across teams.
4. Decentralized approvals slows down processes.
5. Complexities allocating multiple funding sources.

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What Does This Look Like In Practice?

Payment Processes - Large Organization

Process

1. **Program Staff** confirm completion of programmatic deliverables
2. **Grants Accountant** verifies financial compliance
3. **Controller** reviews and approves payment batch
4. **Accounts Payable Team** processes disbursement
5. **Treasury Department** executes payment and reconciles accounts
6. **Internal Audit** periodically reviews transactions

Common Challenges

1. Payment approvals require several layers causing slow turnaround.
2. Siloed departments can make coordination difficult.
3. High volume of transactions can increase risk.
4. Staff turnover and training gaps.
5. Complex cost allocation often including detailed indirect rate application.

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What Does This Look Like In Practice?

Procurement

| Org Size	Policy Emphasis	Complexity	Approved Thresholds	Control Examples
Small	Basic approval, cost reasonableness	Simple, manual	e.g. $1K-$5K	Executive/board review
Medium	Competitive quotes, documentation	Semi-automated	e.g. $5K-$50K	3-way match, Finance Review
Large	Regulatory compliance, competition, audit trail	Fully automated, multi-department	e.g. $10K-$250K+	ERP workflow, internal audit

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Culture of Compliance
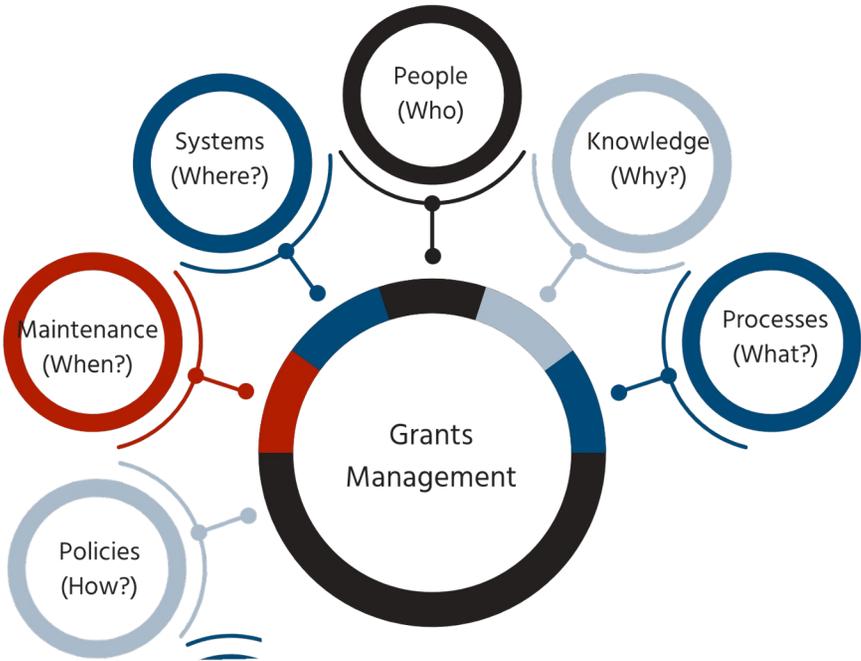
Culture of Compliance

| People (Who)	Knowledge (Why)	Policies (How)	Processes (What)	Maintenance (When)	Systems (Where)
• Financial • Operations • Programs • Leadership • Partners	• 2 CFR 200 • Other legislation and policies	• Building internal controls • Org rules to follow	• "How to" activities and roadmap that adheres to policies	• Kickoff and regular meetings • Project planning • Reporting	• Project or Grant Mgmt System • Manual tracking updates

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Three Ways to Create A Culture of Compliance

1 Policies for financial management and legal governance encourage ethics and sensible use of resources.

2 Establish ongoing meetings and check-ins between different functions and roles responsible for administering grant funding.

3 Create job descriptions that align with the grant administrative functions.

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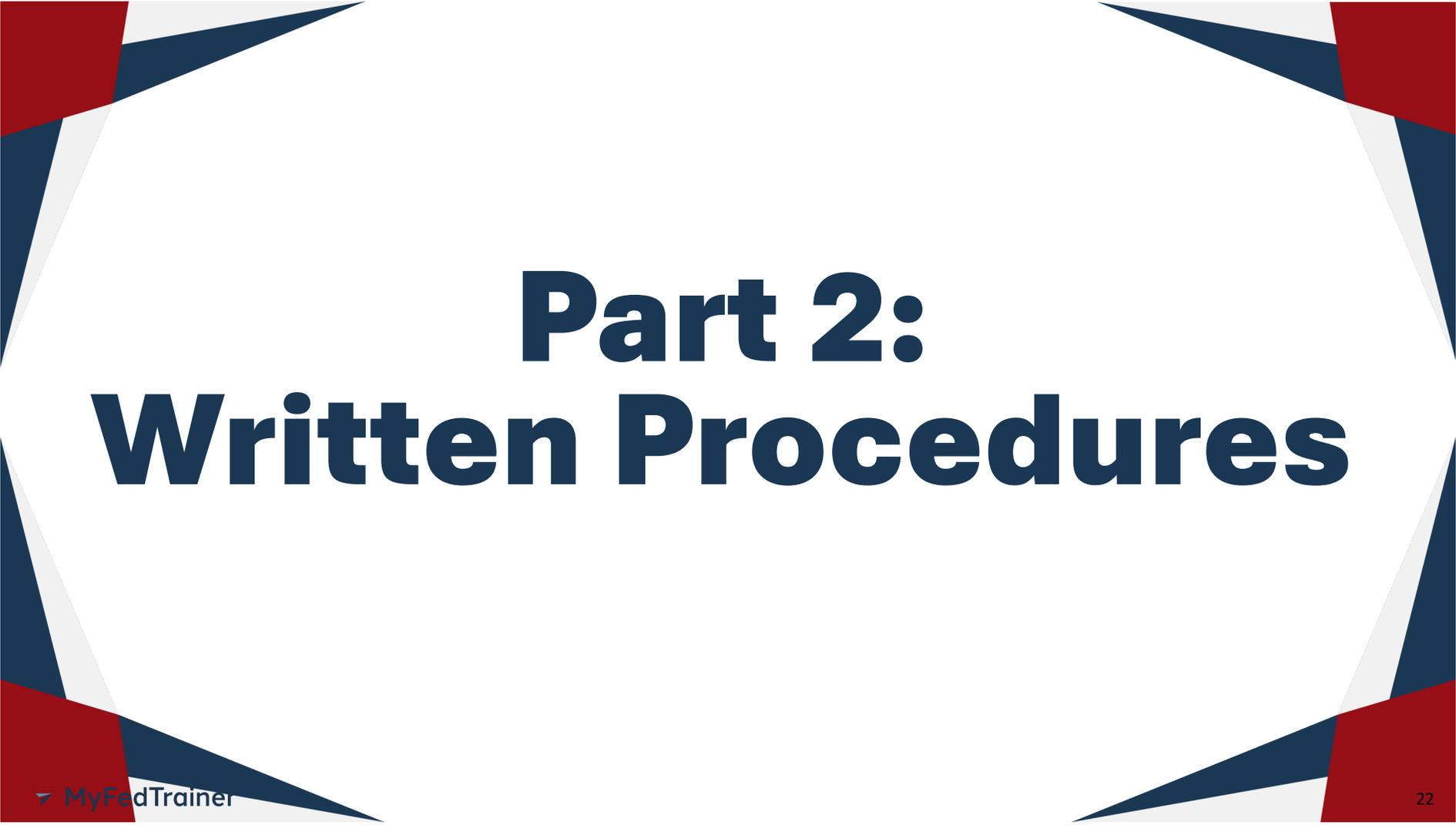
Part 2: Written Procedures
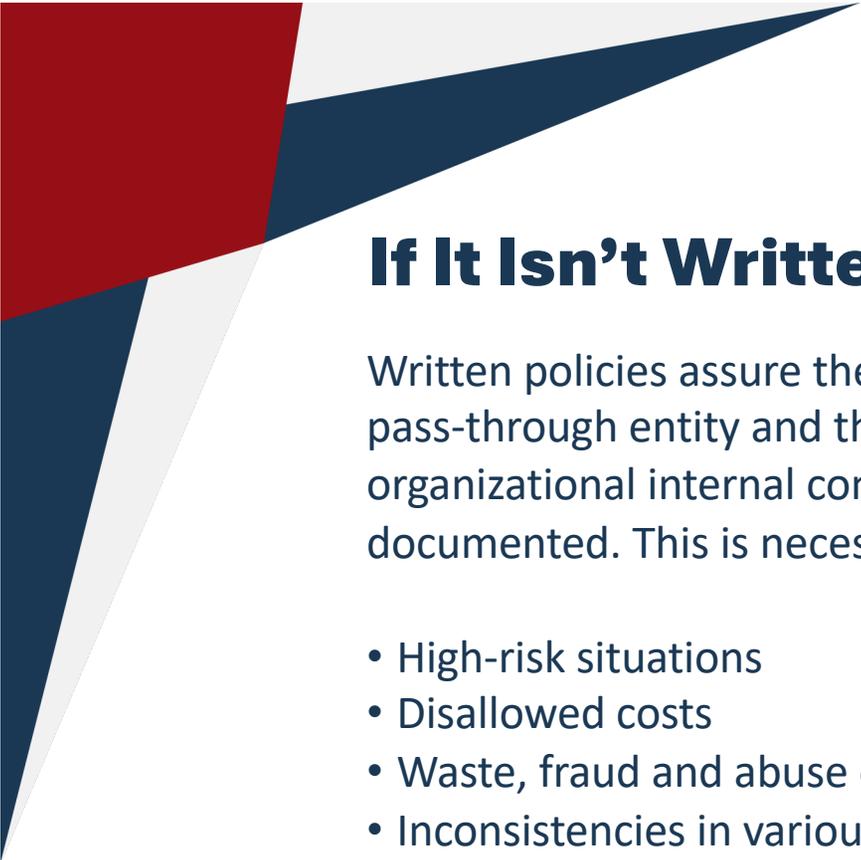
If It Isn't Written, Does It Exist?

Written policies assure the funder, the awarding agency, pass-through entity and the public that you have organizational internal controls in place and are well documented. This is necessary to avoid:

- High-risk situations
- Disallowed costs
- Waste, fraud and abuse of funds
- Inconsistencies in various processes
- Lack of clarity in core grant administrative job functions

Sample Policies To Develop

Ethics

- Report unethical behavior and fraud
- Code of conduct
- Safeguards for employees (whistleblower policy)
- Actions arising from fraud investigations

Funding Oversight

- Reporting structure and important grant dates
- Time and effort reporting
- Performance reviews
- Adherence to national policy requirements (lobbying, non-discrimination policy, drug-free workplaces, debarment and suspension)
- Single audit preparation and management

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Sample Policies To Develop

Program Management

- Program reporting process
- Subrecipient monitoring
- Grant budget tracking
- Prior approval requirements

Financial Management

- Budget management
- Cash management policy
- Coding and monitoring expenses
- Maintenance of effort
- Indirect cost rate agreement
- Travel policy
- Allowable costs policy

- Allowable costs policy
- Budget special categories (program income, carryover)
- Procurement policy
- Equipment management and retention
- Record keeping policy

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Case Study
Unclear Policy and Misallocated Costs

Situation
An employee is traveling for work and decides to add a few extra days for vacation to the end of their trip. The travel policy is not clear so the employee by default charges the entire stay to the company.

Violation
Unallowable cost (personal travel)

Outcome
Material weakness in audit, required repayment of $2k, corrective action plan

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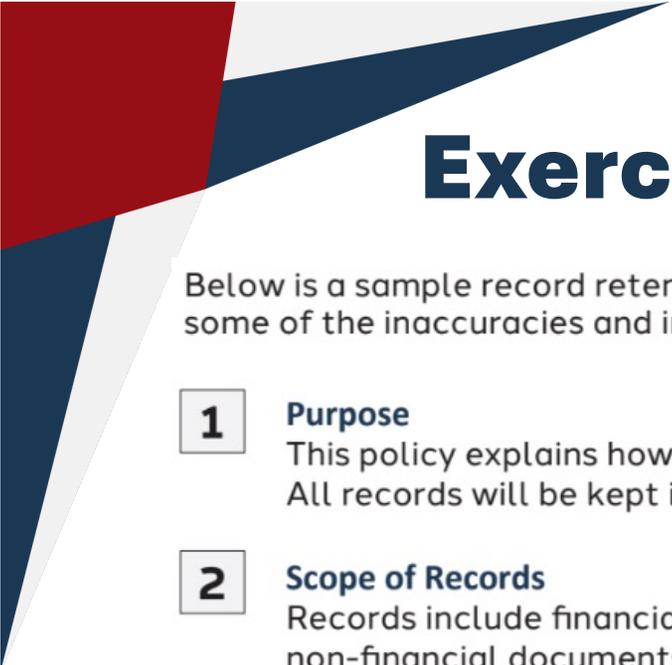# Lessons Learned From Case 1

✓ **Clear travel policy** linked to award terms

✓ **Pre-approval** of travel itineraries

✓ **Regular expense reviews** by finance staff

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Exercise 2

Review a sample record retention policy to see what is missing.

Exercise 2

Below is a sample record retention policy, but some of the information is correct. Can you spot some of the inaccuracies and indicate what they should be instead?

1 **Purpose**
This policy explains how our organization keeps and stores records for all federal grants. All records will be kept in paper format and stored in departmental filing cabinets.

2 **Scope of Records**
Records include financial statements and receipts related to each federal award. Other non-financial documents are optional and only kept if useful for program staff.

3 **Retention Period**
Our organization follows a general rule that all records must be retained for **three years from the end date of the period of performance** for each federal award.

After that date, all records may be disposed of unless the Federal agency tells us otherwise verbally.

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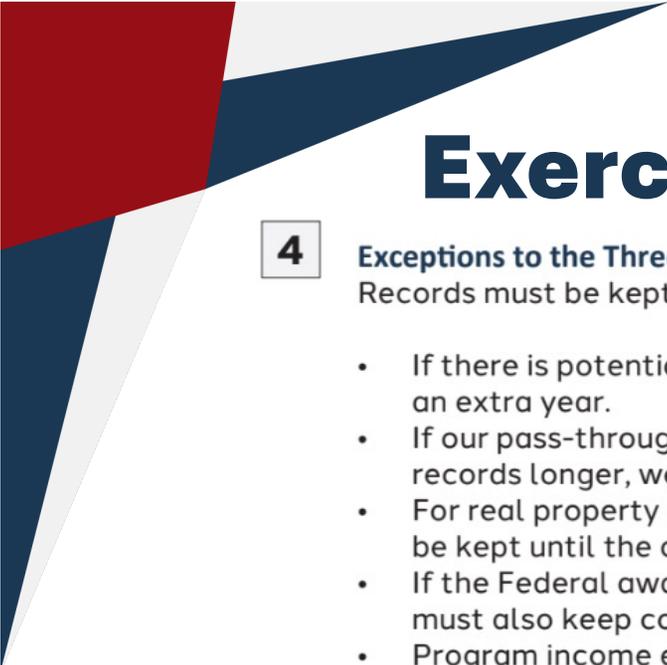
Exercise 2

4 **Exceptions to the Three-Year Rule**
Records must be kept longer in the following cases:

- If there is potential litigation, the organization may choose to hold on to the records for an extra year.
- If our pass-through entity or federal agency gives us a phone call asking us to retain records longer, we will keep them until further notice.
- For real property or equipment purchased under a Federal award, records only need to be kept until the closeout date of the award.
- If the Federal awarding agency maintains its own copies of the records, the recipient must also keep copies for three years.
- Program income earned after the period of performance does not affect the retention timeline.
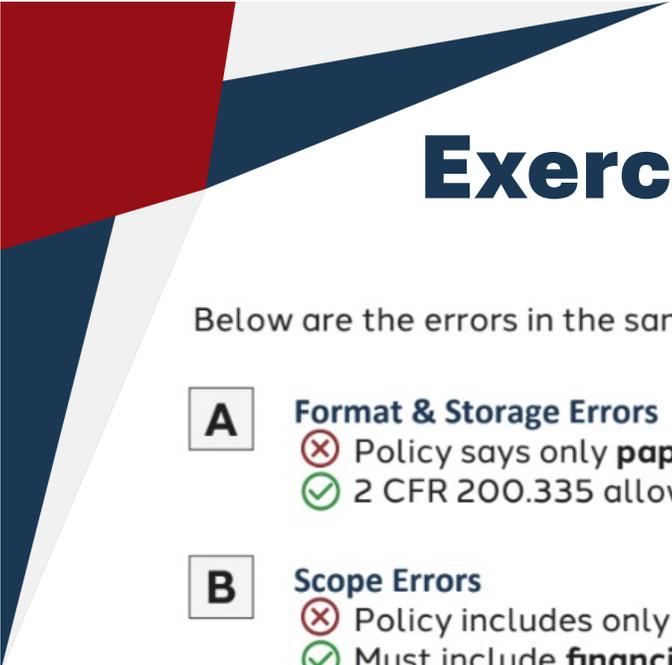
5 **Access to Records**
Auditors may request records, but the organization can deny access if the request is made more than two years after the end of the period of performance.

6 **Destruction of Records**
Once the retention period expires, staff may dispose of records by throwing them in the regular trash, unless the program director instructs otherwise.

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Exercise 2- Answers

Below are the errors in the sample policy and the correct requirements participants should identify.

A **Format & Storage Errors**
- ⊗ Policy says only **paper records** are used
- ⊘ 2 CFR 200.335 allows **electronic formats**, scanned copies, cloud systems, etc.

B **Scope Errors**
- ⊗ Policy includes only financial documents
- ⊘ Must include **financial, programmatic, statistical, electronic, and all records pertinent to the award**

C **Incorrect Retention Rule**
- ⊗ Says retention is three years from the end of period of performance
- ⊘ Must be three years from **submission of the final FFR or equivalent closeout report** (or from the due date of each periodic report for annual/quarterly reports)

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Exercise 2- Answers

D **Incorrect Exception Statements**
Participants should identify:

1 **Litigation/claims/audit findings**
- ⊗ "Organization may choose…"
- ⊘ Must retain **until fully resolved**—no discretion

2 **Verbal notification**
- ⊗ "Phone call or verbal instructions"
- ⊘ Extension requires **written notice**

3 **Property/equipment**
- ⊗ Says retention ends at closeout
- ⊘ Must retain **3 years after final disposition**, which may be years later

4 **Records held by Federal agency**
- ⊗ Says recipient must still keep copies
- ⊘ If the Federal agency maintains records, **recipient does not** need to keep them

5 **Program income**
- ⊗ Says program income earned after period of performance "does not affect timeline"
- ⊘ Retention begins at **end of fiscal year in which program income was earned** (for cases requiring post-PoP reporting)

E **Access Errors**
- ⊗ "Organization can deny access after 2 years"
- ⊘ Must allow access **for as long as records are retained**

F **Destruction Errors**
- ⊗ "Throwing records in regular trash"
- ⊘ Must ensure **secure destruction**, especially for confidential or personally identifiable information

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Part 3:
Record Keeping

Why Is Record Keeping Important?

- Required in 2 CFR 200.334 – Record Retention
- A component of your internal controls process
- Involves program, financial, and administrative staff
- Ensuring access to accessible information is critical for single audit preparation

If it's not in the file, it didn't happen!

Types of Records

Record retention includes many types of records:

- Financial records

- Procurement records

- Real property and equipment records

- Subrecipient monitoring documentation

- Suspension and debarment compliance

- Contract provisions (such as Davis Bacon Act)

- Audit records and corrective action plans

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Timeframe

The general rule for record retention:

- 3 years from the date of submission of the final expenditure report, but some exceptions and often longer period required….

- If federal agency authorizes: 3 years from the date of submission of the annual or quarterly expenditure report

Coronavirus State and Local Fiscal Recovery Funds require 5 years of record retention

Right To Access

The right to access records extends as long as records are retained..

- If records exist, they are available for review

- They are DISCOVERABLE!

- Right to timely and unrestricted access to personnel – current and past employees

- For interviews and discussions related to documents pertinent to the award

Data Privacy

The purpose of data privacy is to:

- Protect sensitive and personally identifiable information (PII) collected, used, or maintained through grant activities.
- Ensure compliance with federal privacy, cybersecurity, and record retention regulations (e.g., 2 CFR 200.334–.338, Privacy Act, FOIA).

The key principles are of this are:

- Confidentiality
- Integrity
- Availability
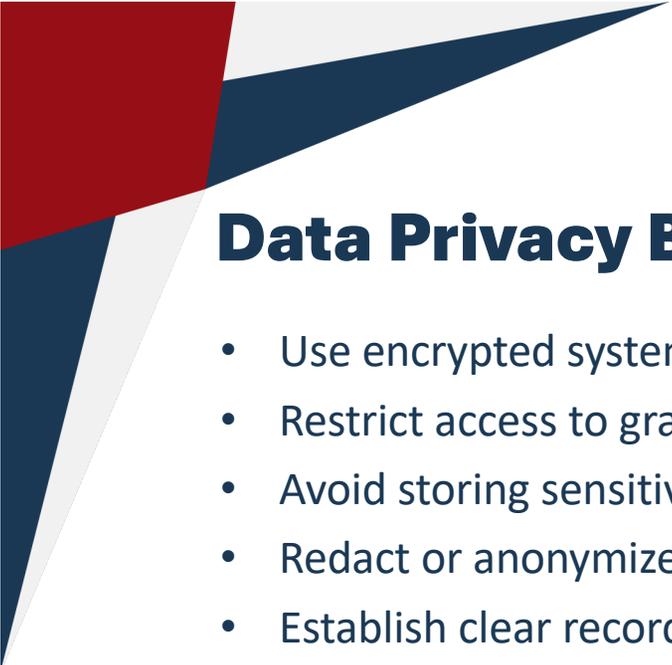
Data Privacy Best Practices

- Use encrypted systems and secure servers for storage and transmission.

- Restrict access to grant data based on role and necessity.

- Avoid storing sensitive data on personal devices.

- Redact or anonymize data when sharing with subrecipients or auditors.

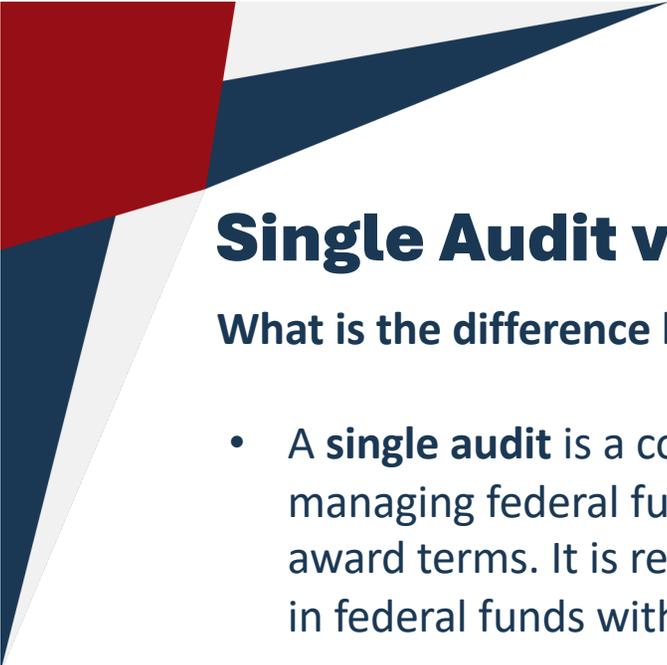- Establish clear record retention and destruction schedules.

# Handout 2.2: Data Privacy and Technology in Federal Grants

Download your resource!

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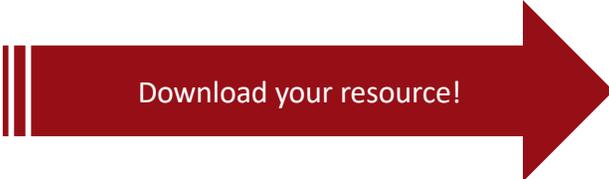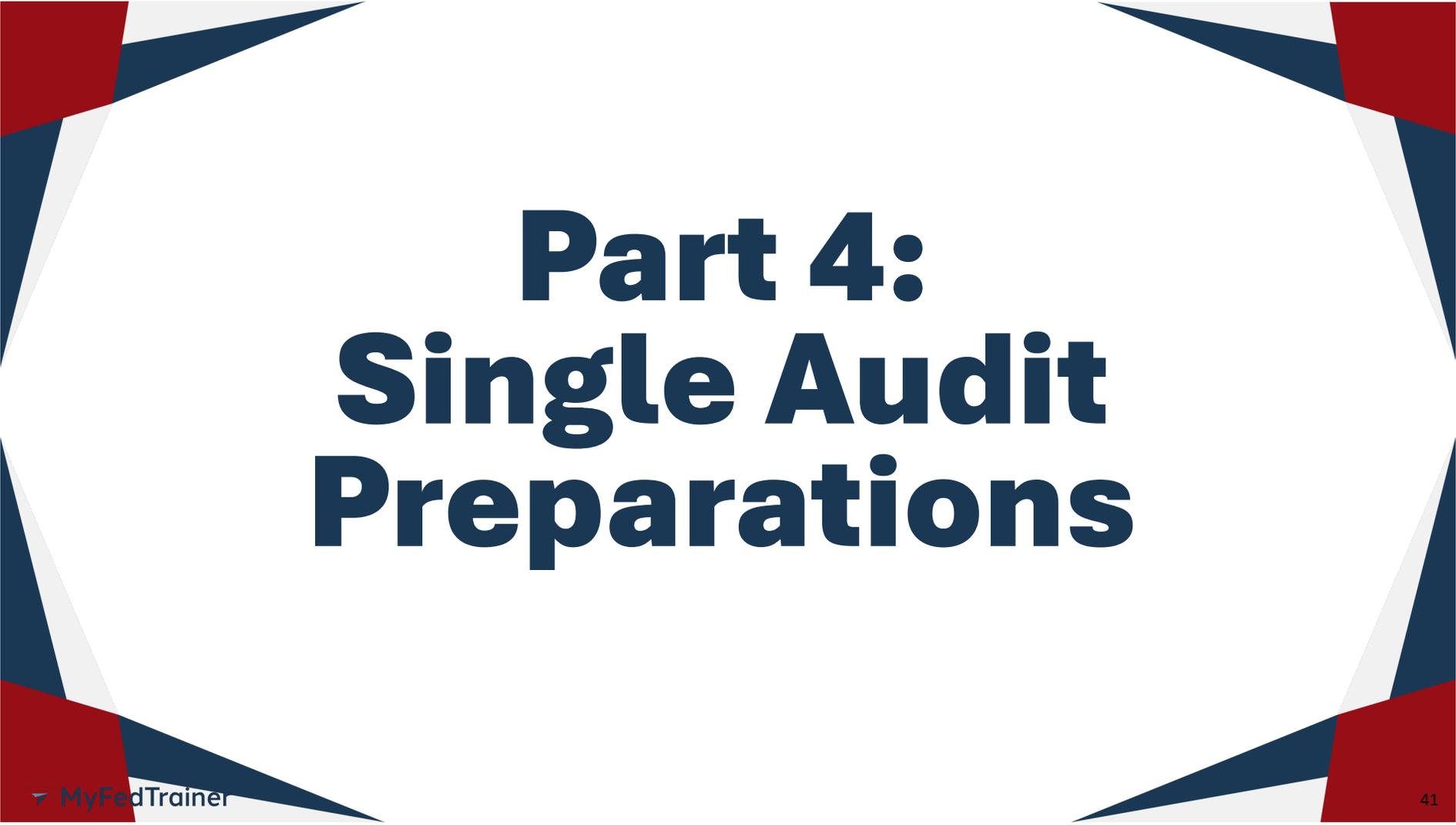
Part 4:
# Single Audit
Preparations

Single Audit vs. Program Audit

What is the difference between a single audit and a program audit?

- A **single audit** is a comprehensive audit to ensure that the organization is managing federal funds appropriately, in compliance with laws, regulations, and award terms. It is required for grantees and subgrantees who expend over $1M in federal funds within their fiscal year.

- A **program audit** focuses on an individual federal program, including program objectives and compliance with award terms and conditions. The Uniform Guidance Audit Requirements can be found in 2 CFR 200 Subpart F.
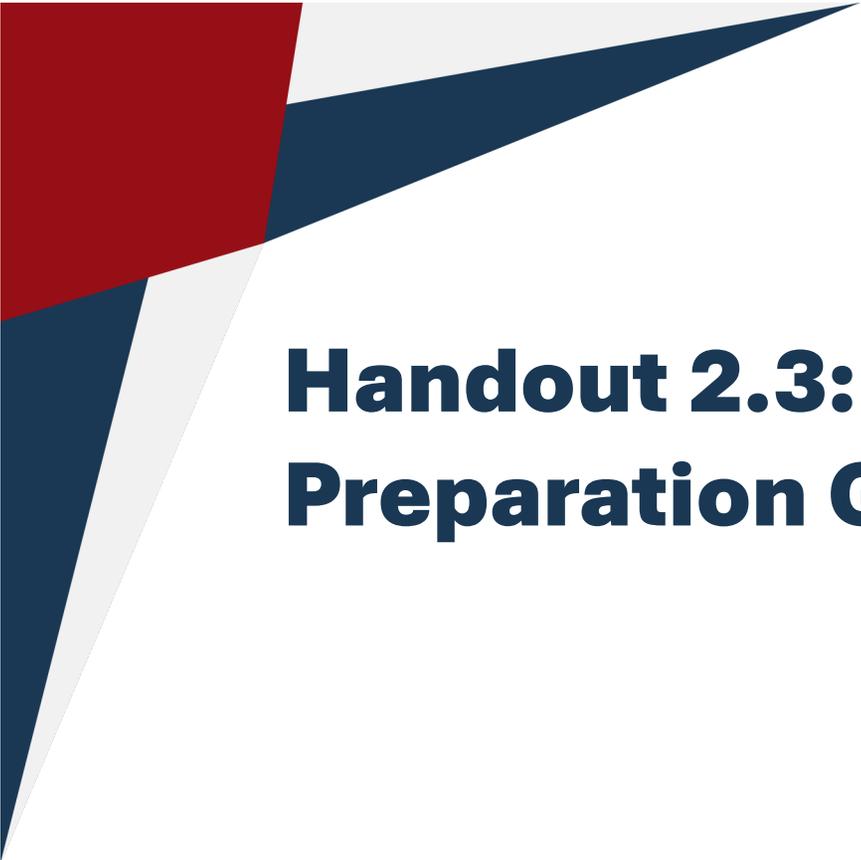
Handout 2.3: Single Audit Preparation Guide
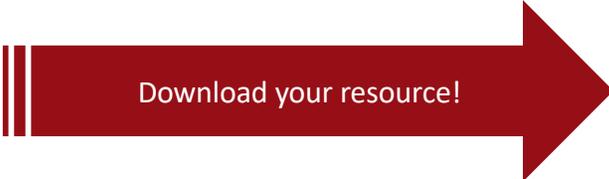
Download your resource!

9 Tips

1	Establish and maintain	Establish and maintain the control environment.
2	Comply	Comply with terms and conditions of awards and fed, regulations. Review the Compliance Supplement!
3	Take	Take immediate corrective action steps for identified noncompliance and audit findings.
4	Protect	Protect Personally Identifiable Information (PII).
5	Procure	Procure auditor according to compliant procurement policies and procedures (auditor may not prepare indirect cost rate proposal).

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9 Tips

|		
6	Prepare	Prepare the Schedule of Expenditures of Federal Awards (SEFA) and schedule of prior findings.
7	Provide	Provide auditor access to records.
8	Monitor	Monitor the audit contract as with any other contractor.
9	Prepare and Submit	Prepare auditee sections of data collection form (SF-SAC), upload the report to the Federal Audit Clearinghouse (FAC).

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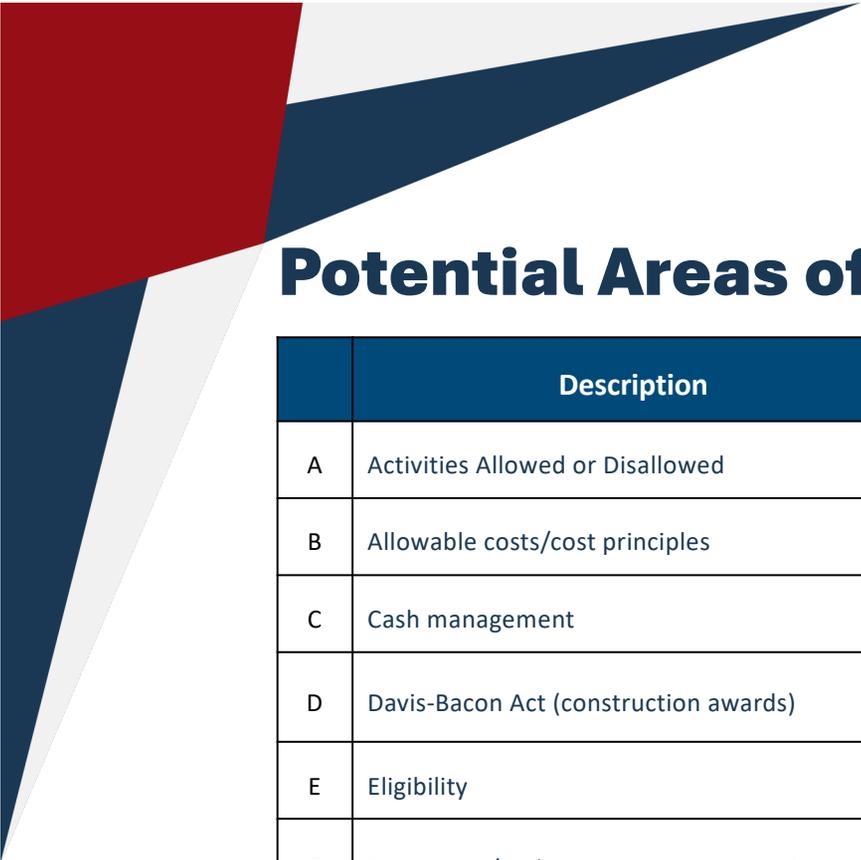
Potential Areas of High Risk

|	Description		Description
A	Activities Allowed or Disallowed	H	Period of performance
B	Allowable costs/cost principles	I	Procurement/Suspension & debarment
C	Cash management	J	Program income
D	Davis-Bacon Act (construction awards)	K	Real property acquisition and relocation assistance
E	Eligibility	L	Reporting
F	Equipment/real property management	N	Subrecipient monitoring
G	Cost share, level of effort, earmarking	O	Special Tests and provisions

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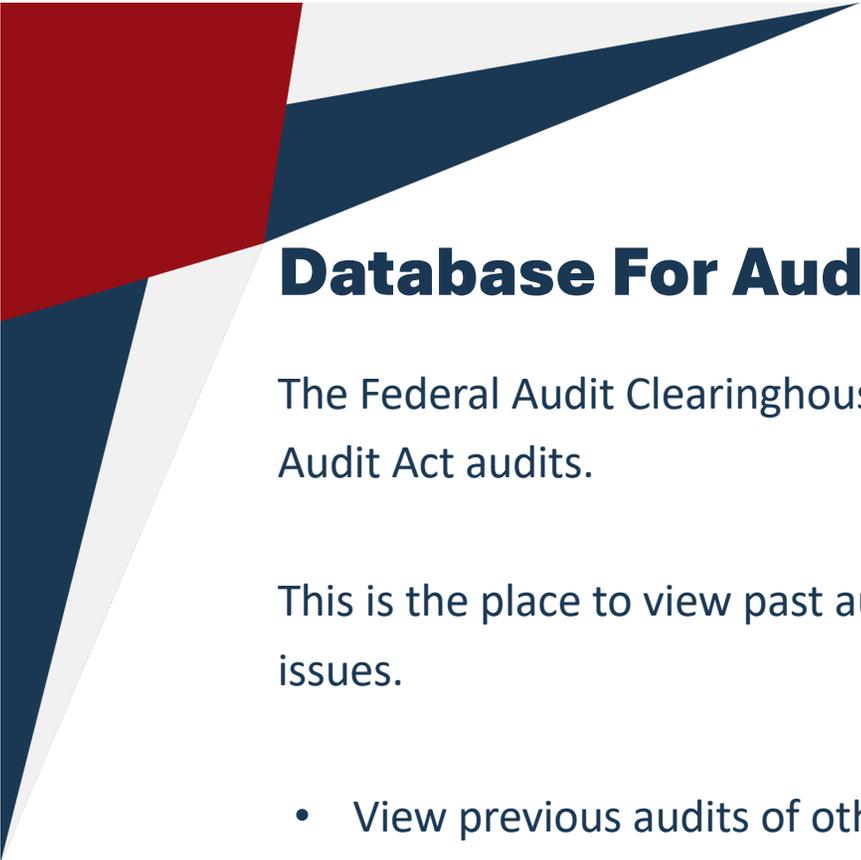
Database For Audits

The Federal Audit Clearinghouse (FAC) is the home of completed Single Audit Act audits.

This is the place to view past audits and gain insights into common audit issues.

- View previous audits of others, including subrecipients
- Discover audit findings and open corrective action at https://fac.gov
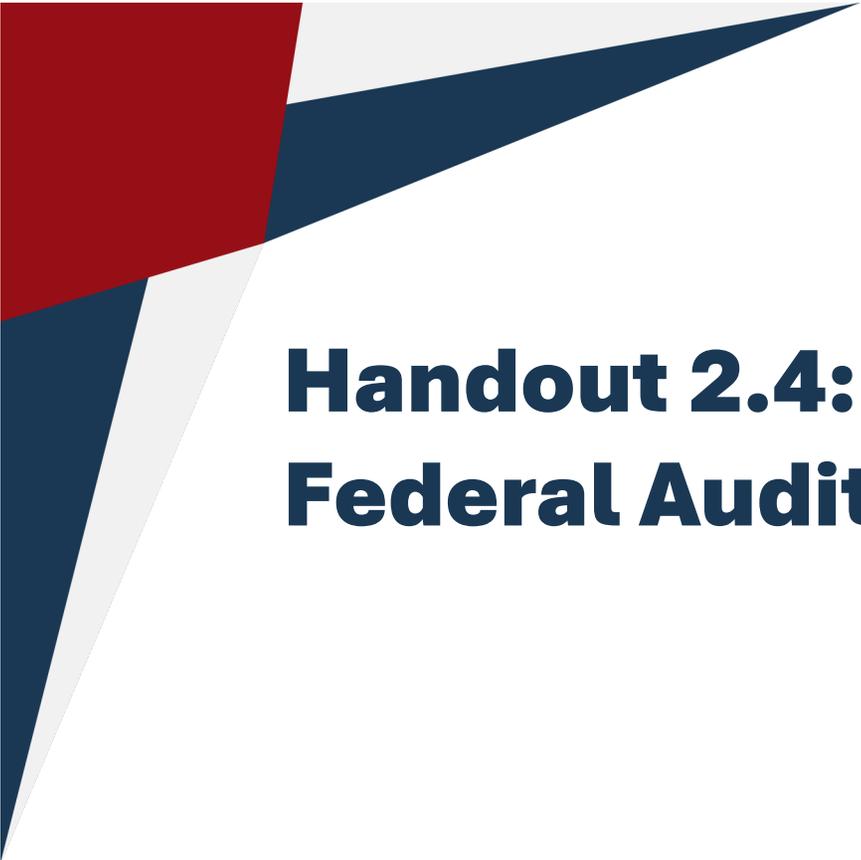
Handout 2.4: Searching the Federal Audit Clearinghouse
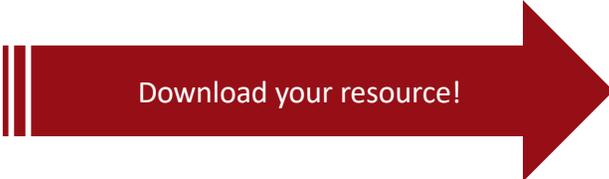
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Session Review

✓ The objectives of strong internal controls is compliance with regulations and terms and conditions of the federal award.

✓ Important to prepare policies that comply with 2 CFR 200 requirements and cover different control functions, including recordkeeping.

✓ Build a culture of compliance to successfully implement your policies Grant recipients are audited that meet the required threshold.

✓ Establishing and implementing policies up front lessens the burden of compliance.

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❓ Questions