Internal Controls General Guidance

Recipients of federal funding—including those receiving American Rescue Plan Act (ARPA) State and Local Fiscal Recovery Funds (SLFRF)—must establish and maintain effective internal controls to ensure compliance, accountability, and proper stewardship of public funds. The federal government requires all recipients of federal awards to implement internal controls ensuring funds are used for eligible purposes and comply with applicable laws and regulations. This requirement applies across all SLFRF eligible use categories, including Revenue Replacement (Revenue Loss), and is a fundamental expectation of responsible federal fund management.[1]

What Are Internal Controls?

An internal control is a system or procedure an organization establishes to ensure activities related to their funds allocation are conducted properly. Sufficient internal controls are required by the Federal government to ensure that a recipient of federal funding operates efficiently and effectively, produces reliable reports for internal and external use, and complies with all applicable laws and regulations. [2]

Key aspects of internal controls include:

- **Financial Management:** Recipients must maintain accurate financial records and implement systems to track the use of funds, ensuring expenditures align with eligible uses.
- **Monitoring and Reporting:** Recipients are responsible for monitoring subrecipients and contractors to ensure compliance with SLFRF requirements. This includes verifying that funds are used for authorized purposes and performance goals are achieved.[3]
- **Record Retention:** Recipients must retain records related to SLFRF expenditures, including documentation of obligations and expenditures, for audit and compliance purposes. For most federal programs, records must be retained for a minimum of three (3) years from the date of submission of the final expenditure report (2 CFR §200.334). For SLFRF specifically, records must be retained for five (5) years after the later of the date funds are expended or returned to Treasury.[4]

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[1] U.S. Department of the Treasury, "Compliance and Reporting Guidance: State and Local Fiscal Recovery Funds," Version 10.0, April 2025, p. 2.
[2] 2 CFR §200.1, Uniform Administrative Requirements, Definitions.
[3] SLFRF Final Rule FAQ #13.15, updated April 2025.
[4] 2 CFR §200.334, Record Retention and Access.

- **Internal Controls Framework:** Recipients must implement policies and procedures to prevent fraud, waste, and abuse. This includes segregation of duties, regular reconciliations, and oversight mechanisms.
- **Compliance with Federal Laws:** Recipients must adhere to applicable federal laws, such as civil rights and nondiscrimination requirements, and ensure subrecipients comply with all applicable standards.
- **Audit Requirements:** Recipients are subject to Single Audit Act requirements (2 CFR Part 200, Subpart F) and must ensure that their internal controls support accurate reporting and compliance with SLFRF guidelines. SLFRF recipients whose total federal expenditures meet or exceed the single audit threshold are required to undergo an annual independent audit. Audit findings related to internal control weaknesses or noncompliance with federal requirements must be promptly addressed and corrected. [5]

Why Do Internal Controls Matter for SLFRF?

Internal controls matter for entities that have received federal funding, including ARPA SLFRF awards, both because they are required by federal law and as they help ensure that public funds are used properly, transparently, and effectively. [6]

Why It Matters	Summary
Legal Requirement	2 CFR §200.303 requires recipients to establish and maintain effective internal controls as a condition of receiving federal funding.
Prevents Fraud, Waste, and Abuse	Controls catch and prevent unallowed expenses, duplicate payments, and intentional or accidental misuse of public funds.
Supports Compliance with SLFRF Rules	Helps municipalities meet SLFRF's strict requirements on eligible uses, reporting deadlines, and documentation, reducing audit findings and the risk of repayment.
Promotes Transparency and Public Trust	Enables towns to demonstrate how decisions were made, how funds were spent, and respond confidently to public and federal inquiries or audits.

[5] U.S. Department of the Treasury, "SLFRF Final Rule," 87 FR 4338, Jan. 27, 2022.
[6] 2 CFR §200.303(a)-(e); SLFRF Final Rule Overview (2022), p. 43

Improves Efficiency and Oversight	Even small towns with limited staff can use checklists, risk assessment templates, and delegation of authority documents to ensure sound decision-making and catch problems early.

Key Principles of Internal Controls

The federal standards for internal control, as outlined in GAO-25-107721 (Standards for Internal Control in the Federal Government) and 2 CFR §200.303, identify five key components that SLFRF recipients should use as a framework for their internal control systems:

- **Control Environment:** The foundation for all other components. Leadership sets the tone for accountability, integrity, and competence. Recipients must demonstrate commitment to ethical values and ensure staff understand their responsibilities related to SLFRF compliance.
- **Risk Assessment:** Recipients must identify and analyze risks that could prevent achieving compliance objectives, including risks of fraud, waste, and abuse of SLFRF funds. Risk assessments should be performed regularly and whenever program circumstances change.
- **Control Activities:** Policies, procedures, and mechanisms that help ensure management directives are carried out. Examples include approval thresholds, segregation of duties, reconciliations, and documentation requirements for SLFRF expenditures.
- **Information and Communication:** Recipients must obtain and communicate information necessary to achieve compliance objectives. This includes internal reporting on fund usage, communicating roles and responsibilities, and maintaining records sufficient for SLFRF reporting and audit purposes.
- **Monitoring Activities:** Ongoing evaluations to confirm that internal controls are present and functioning. Recipients should balance timely program delivery with robust documentation and compliance practices and conduct regular reviews to confirm that public funds are being used appropriately and transparently.

Federal Requirements and Best Practices

- Recipients must develop and implement effective internal controls to ensure funding decisions align with eligible uses and document determinations (2 CFR 200.303).
- Internal controls are essential for compliance with Cost Principles (2 CFR Part 200, Subpart E).

The table below illustrates common internal control best practices and examples drawn from SLFRF Revenue Replacement activities. This list is illustrative and not exhaustive; recipients should tailor controls to their specific projects, staffing, and risk areas.

Table 1: Internal Controls Best Practices[7]

Best Practice	Example
Written policies and procedures	Documented steps for determining if spending under Revenue Replacement aligns with government services allowed under the Final Rule (e.g., staff salaries, maintenance).
Written standards of conduct	Code of conduct for staff handling infrastructure, payroll, or capital projects funded under revenue replacement.
Risk-based due diligence	Review of past financial management or compliance issues when allocating Revenue Replacement funds to departments or contractors.
Risk-based compliance monitoring	Closer oversight of projects involving large capital purchases or contracted services (e.g., roadwork) funded under Revenue Replacement.
Record maintenance and retention	Retention of documentation supporting the decision to categorize spending under Revenue Replacement, such as council meeting minutes or budget justifications.
Approval thresholds	Written thresholds for when additional approvals are needed for purchases using Revenue Replacement funds (e.g., supervisor for $5K+, council for $25K+).

[7] This table provides illustrative examples of internal controls that are commonly helpful for SLFRF, particularly for towns using Revenue Replacement/Revenue Loss, but it is not exhaustive. NEUs should tailor controls to their specific projects, staffing, and risk areas, and may need additional controls (e.g., subrecipient monitoring, procurement documentation, reporting review) depending on how SLFRF funds were used.

Documented use of funds	Maintain logs showing Revenue Replacement expenditures match eligible government services as defined by SLFRF guidelines.
Separation of duties	Ensure different staff approve, process, and reconcile payments made using Revenue Replacement funds.
Internal reporting schedule	Regular internal updates on Revenue Replacement fund use to ensure alignment with plans and prevent misuse.
Capital asset tracking	Inventory logs for vehicles purchased with SLFRF funds.
Delegation of authority document (small towns)	A one-page document signed by the mayor or town manager specifying who may authorize SLFRF purchases and at what dollar thresholds (e.g., clerk up to $1K, manager up to $10K, council above $10K).
Simple expenditure log (small towns)	A simple spreadsheet tracking each SLFRF expenditure, the date, amount, payee, eligible use category, and who approved it—sufficient for audit purposes even in towns with one or two staff.

Compliance Reminders

- Recipients must maintain records for 5 years after funds are expended or returned to Treasury (2 CFR §200.334).
- Records should be collected, transmitted, and stored in open and machine-readable formats.
- Recipients must evaluate subrecipients' risk of noncompliance and conduct ongoing monitoring based on assessed risk.
- Written policies and procedures for subrecipient monitoring and risk assessment are required.

This guidance is based on current information from the U.S. Department of the Treasury and is subject to change. It does not constitute legal advice. The State of Maryland and Hagerty Consulting Inc. are not responsible for any compliance decisions made based on this document. As a recipient of federal funds, each unit of government is responsible for the administration and compliance of Fiscal Recovery Funds and other federal funding.

Appendix: Internal Controls Checklist

This checklist is designed to help small municipalities evaluate and implement core internal controls related to SLFRF funds.

Governance & Planning

- ☐ Written internal controls policy in place (per 2 CFR §200.303)
- ☐ Use of Committee of Sponsoring Organizations (COSO) or equivalent internal control framework
- ☐ Clear delegation of authority for approvals and financial decisions

Revenue Replacement Controls

- ☐ Documented justification of eligible government services
- ☐ Council minutes or budget memos support revenue replacement allocations
- ☐ Regular internal reporting of fund usage to senior staff or council

Procurement & Financial Management

- ☐ Procurement procedures include threshold approval levels
- ☐ Standards of conduct for procurement staff are documented
- ☐ Reconciliation of expenditures occurs monthly
- ☐ Capital asset log maintained

Subrecipient Oversight

- ☐ Risk assessments conducted for all subrecipients
- ☐ Subrecipient monitoring procedures documented
- ☐ Site visits or desk reviews scheduled and conducted regularly

Recordkeeping & Audit Readiness

- ☐ Record retention plan in place (5-year minimum)
- ☐ Files are organized and accessible in machine-readable format
- ☐ Single Audit threshold ($750,000) reviewed annually