

## **Impact of Internal Controls in Managing Resources of Small Business: Case Study of Botswana**

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### **Abstract**

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This paper examines the importance of internal controls in managing resources of small businesses of Botswana. This research is driven by the arguments that small businesses lack internal control as a result they end up failing. Different authors propose that internal controls play an important role in preventing abuse and misuse of resources. The research here is designed to investigate further into this issue by assessing whether small businesses have internal controls and if so whether internal controls are costly to implement. This was done by obtaining information from 52 randomly selected respondents and the conclusion derived from these responses is that internal controls are significant in managing resources of a small business hence owners and employees should train themselves in order to be more knowledgeable about internal controls. It is noted that the owners were aware that there should be internal controls in place but identified they are not in a position to maximize the effectiveness of internal controls to their advantage.

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**Keywords:** Internal controls, Small business, Resources management, Training

### **Introduction**

In the study made by the Task Force in the year 1998, it was identified that a number of small businesses present in Botswana are roughly at around 56300 (small, medium enterprises). This number is big and shows growth in the economy hence the implementation of internal control is strongly recommended to avoid failures. The use and maintenance of resources of the small businesses in Botswana depend on the execution of internal controls which is the most important aspect in businesses.

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It is observed that most of small businesses have no internal controls in place because they are costly to implement. These entities are sometimes run by the owner and responsibility of bookkeeping is usually given to one or two persons (Modisane, 2013). While the owner is still busy chasing after other business opportunities or enjoying success, resources can be wasted and used for purposes other than the one for business (Campbell and Hatcher). That is the crux of the problem where the issue of business failure comes in because the resources are not managed properly. Lack of adequate controls results in workers stealing. Senior management has responsibility for implementing good internal control (Ifuzue, 2008). If the senior management is not portraying good behavior then employees would not follow the code of ethics that exist in an entity. The Enron scandal showed that the management had created a bad culture of not using resources properly therefore employees also followed it ([finance.laws.com/Enron-scandal-summary](http://finance.laws.com/Enron-scandal-summary)). In the United States companies are required to have excellent internal controls in place, this is a legal obligation therefore management should comply with these regulations. Foreign Corrupt Practices Act (FCPA) of 1977 requires companies to have good internal controls to provide reasonable assurance that access to assets is at the management's discretion (Guide to Internal Control Financial Reporting).

### **Problem Statement**

Small businesses should implement effective internal controls just like big companies. But due to the higher costs of putting internal controls. In Botswana most small businesses do not have internal controls in use. Now these entities are faced with a problem of misuse of resources available and this is because mostly keeping of records is under the responsibility of one or two people. With these perpetration and smuggling of resource is bound to happen. Owners often have no interest in the books of accounts because they are too busy. Due to the lack of internal controls, misusing of business resources may creep in.

### **Objectives**

The objectives of this research are:

1. To find out existence and use of internal controls in small business.
2. To identify the awareness of small businesses regarding the internal controls and how often the internal audit performed to test the effectiveness of internal controls.

3. To locate system used in order to find out leakages of resources.
4. To highlight the existence of established government regulations that ensure small businesses adhere to the international standards on internal controls.

### **Hypotheses**

1. Internal controls are expensive therefore Small businesses in Botswana have not implemented internal controls.
2. Small business fail because the owners/management are not familiar with the internal controls.
3. Authorization and record keeping are done by the same person thus increasing chances of having resources being wasted.

### **Scope of the Study**

The research is based on small businesses of Botswana particularly those in Gaborone (capital city of Botswana) and surrounding areas, targeted internal controls of ventures like law firms, hair salons, medical clinics and small restaurants to find out if they had effective controls.

### **Conceptual Clarifications**

Internal control consists of policies and procedures designed to provide management with reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations (Arens, 2012).

Small business is an enterprise that is independently owned and operated for profit and that is not dominant in its field (Bryd, 2009).

Resources refer to anything can be used in the production process namely land, capital, labor and enterprise (Business dictionary.com)

## Literature Review

Internal controls aid an organization in safe guarding the value of assets and ensure that they comply with the existing rules and regulation ([www.unicreditgroup.eu/en/govenace/internal-control-system.html](http://www.unicreditgroup.eu/en/govenace/internal-control-system.html)). The institute of internal auditors (IIA) is of opinion that effective system of internal controls aid in ensuring the organizational processes functioning properly, securing reliable financial information and application of regulations. It is also noted that the business implements controls to protect them from fraud and abuse (Flick, 2010). In the study conducted by the Association of Certified Fraud Examiners (ACFE) small businesses suffer from large losses due to occupational fraud and abuse and these enterprises cannot survive such losses therefore they need to protect themselves from fraud (Bishop, 2004).

Internal controls differ according to the size of businesses. The complexity of controls depends on the type of operations carried by the firm, its size and location. Small businesses should be aware of the internal controls, examine the firm's mandates before putting them in place for better management and control of assets ([www.sba.gov/sites/default/files](http://www.sba.gov/sites/default/files)). Small business owners should be ever mindful of internal controls because they have the responsibility and accountability to make sure that internal controls are working properly (Campbell and Hatcher). It is the management's responsibility to set operating standards to measure an entity's efficient and economical use of resources (Bank of Botswana Internal Audit Charter, 2013) and more so the senior management should implement controls and monitor them more efficiently (Landes, 2007). Accountants can rescue small business owners on the design and implementation of internal controls because most of them lack knowledge on internal controls (Long, 2009). Implementation of basic internal controls and over viewing the accounting functions can minimize chances of employee theft. This initiative would reduce instances whereby small business owners reward themselves unnecessarily, buying expensive cars and luxury trips. The money used to finance these activities usually belongs to the business and this is labeled as mismanagement of resources (Tihomola).

It is difficult to segregate incompatible duties in small firms (Spencer) hence authors like (Davis) state that it is necessary for employees to have custody of assets should be to the single worker. Then problems could be traced to that employee. Finally, the main aim is to achieve the business's objectives (Birabwa, 2009).

## **Methodology**

### Sampling Scheme

For the purpose of this research, a quantitative research method was used since it allows for responses to be given numerical codes, classified and reduced to numbers so that data could be analyzed statistically (Cooper,2011).This method allowed for use of probability, focused on objectivity and highly interested in prediction. The data was then presented using descriptive statistics. Of the two types of probability sampling restricted and unrestricted (Cooper, 2011) and probability sampling (Hathla), the scholars used random sampling method in this research.

### Period Covered

The period 1998 to date is significant taking into consideration that 1998 saw a report by Task Force policy on small businesses from Botswana Institute for Development Policy Analysis and the scholars desired to identify the transition of those enterprises form that time to until now.

### Procedure of Data Collection

Both the primary and secondary data was used. Primary data collected and used for the first time without interpretation or assertions of an official opinion or position (Cooper 2011). In this case data was collected through administration of questionnaire and using semi-structured interviews to ascertain qualitative information (Harris, 2010). Many people gave a response to the same question which made the responses to be more efficient and accurate in quantitative analysis (Saunders, 2009). Secondary data (Cooper 2011) is to correlate with primary data; it included reference materials like textbooks, annual reports and others. For the purpose of this research 52 questionnaires were issued and they were all responded to.

### Processing

The above collected data coded and converted into useful data for application of Statistical Program for Social Scientist (SPSS).

## Sources of Information

Majority of small businesses in Botswana were financed by Local Enterprise Authority (LEA), Citizen Entrepreneurial Development Agency (CEDA) and non-governmental agencies such as commercial banks and individuals. These institutions were the perfect places to obtain information related to how internal controls affect small businesses. Further information was obtained from audit firms so as to find out if they encountered such firms failed due to the impact of lack of proper internal controls.

## Analysis of Data

### Demographic Factors

The Table 1 below presents the demographic factors given by the respondents.

**Table 1: Demographic Factors**

Variable	No		Duration of business operation			
	Male	Female	<5 years	6-10 years	11-15 years	>16 years
No	37	15	38	7	4	3
%	71.2	28.8	73.1	13.5	7.7	5.8

Table 1 highlights that out of 52 (100%) respondents male are 37 (71.2%) compared to 15 (28.8%) females. Business units of 38 (73.1%) are operating for less than five years, seven (13.5%) for six to ten years; four for the period between eleven and fifteen years. Only three (5.8%) have managed to operate and survive above sixteen years.

### Business Size

**Table 2: Business Size**

Item	Business size	
	No	%
Small scale	36	69.2
Medium scale	15	28.8
Large scale	1	1.9
Total	52	100

From the given sample, the scholars approached 52 businesses of which 36 (69.2%) were small companies, followed by 15 (28.8%) medium businesses and one (1.9%) large enterprise.

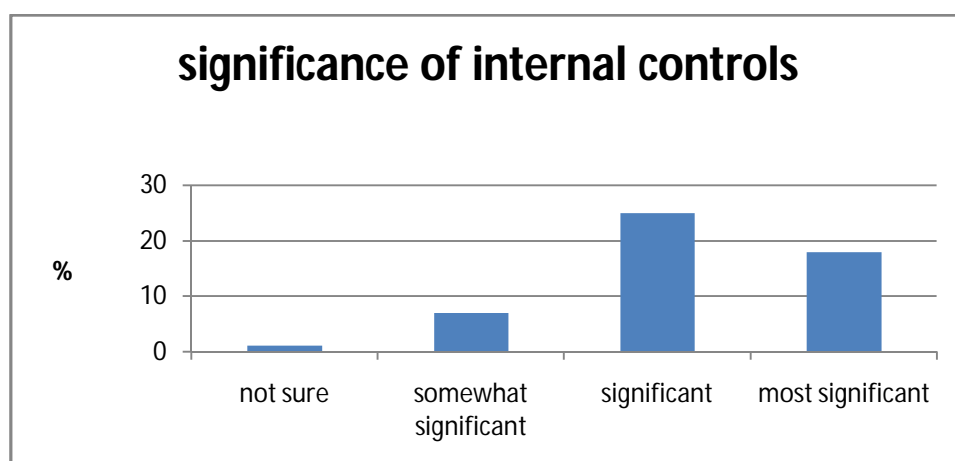
**Table 3: Impact of Internal Controls in Managing Resources of a Business**

Item	Role of internal control in managing resources	
	No	%
Yes	47	90.4
No	4	7.7
Total	51	98.1
Missing system	1	1.9
Total	52	100

Out of 52 respondents, 47 (90.4%) believe internal controls impact most in managing the resources of the business. Four (7.7%) of the people feel internal controls do not play a role in conserving the resources of businesses. This could be due to lack of knowledge of what exactly internal controls do.

#### Significant of Internal Controls

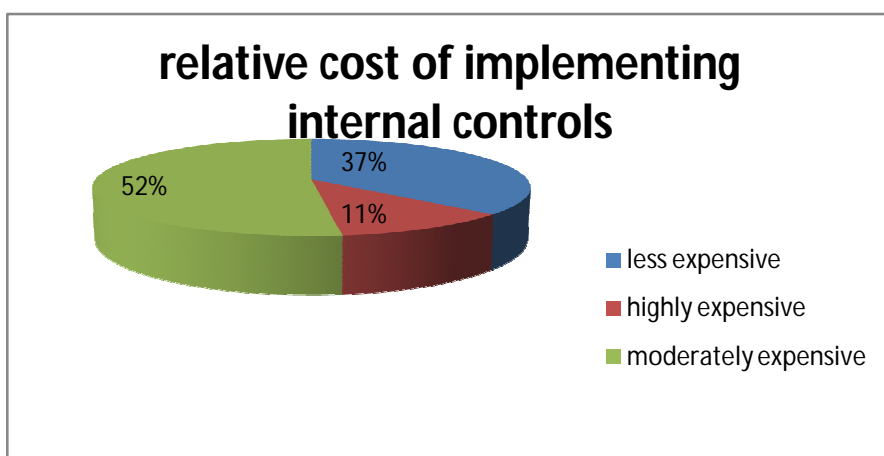
The scholar here wants to know the importance of internal controls as for the view of respondents.



**Graph 1: Significance of Internal Controls**

From the graph above it is shown that out of 52 respondents 18 (34.6%) say that internal controls are most significant in managing the resources of a business, 25 (48.1%) significant, seven (13.5%) somewhat significant, one (1.92%) is not sure. The overall conclusion is that internal controls are significant; it is with the existence of internal controls that physical and monetary assets are protected and guarded against theft and fraud.

### The Relative Cost of Implementing Internal Controls



**Graph 2: Relative Cost of Internal Controls**

From the above findings 27 respondents (52%) stated that internal controls are moderately expensive, 19 (37%) less expensive and six (11%) highly expensive thus concluding that internal controls are moderately expensive to implement. Most of them hired Accounting Firms for Internal Controls, hence the hike in cost.

### Educating Employees about Internal Controls

The channels available are in-service training, prior education and meetings and briefings. The impact of these channels is presented in Table 4.



**Table 4: Impact of Training, Background Education and Meetings on Internal Controls**

	a) Training		b) Education		c) Meetings and Briefings	
	No	%	No	%	No	%
Agree	29	55.8	17	32.7	23	44.2
Strongly agree	14	26.9	15	28.8	17	32.7
Moderately agree	5	9.6	12	23.1	8	15.4
Slightly agree	1	1.9	4	7.7	3	5.8
Disagree	1	1.9	2	3.8	1	1.9
Total	50	96.2	50	96.2	52	100.8
Missing system	2	3.8	2	3.8	0	0
Total	52	100	52	100	52	100

#### a) Training

Table 4 (a) highlights that out of 52, 29 (55.8%) and 14 (26.9%) participants agree that employees can get informed about internal controls through training. Nearly 83% respondents indicated that training for internal controls is required.

#### b) Education Background

Table 4 (b) indicates that prior education will help in understanding the internal controls.

Out of 52 respondents 17(32.7%) respondents agree that employees know about internal controls through education background and 15(28.8%) strongly agree that education background gives employees an informed exposure to internal controls. Only two (3.8%) disagree. The disagreement might be because even superior educational background it is not a guarantee that the business would prosper. Internal controls needs someone who is more knowledgeable about how they operate, because they can mean different things to people hence cause confusion among employees.

#### 4 (c) Meetings and Briefings

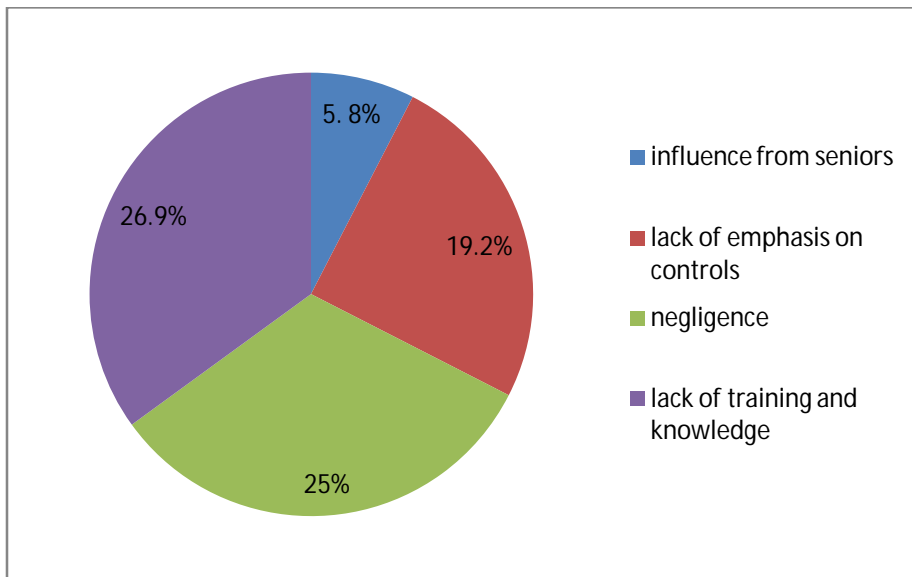
T 4 column (c) shows the rate agreements of respondents regarding meetings and briefings as a medium for learning about internal controls. Out of 52 respondents, 23(44.2%) agree that meetings and briefings could raise awareness about existence of internal controls. 17(32.7%) strongly agree. Since internal controls touch a lot of bases in an enterprise, it is important that employees are informed about them more frequently. This would ensure that employees know everything that needs attention regarding controls hence diminish the chances of fraud and pilferage occurring.

#### Policies in Place about Internal Controls

Most small businesses have no policies regarding internal controls. Some of them have procedures for doing certain things, but they are not aware that this could be policies. Examples of internal control policies could be making sure that no excessive cash stays overnight in the office. Approval of sales and purchases should be done by directors of the company. Some firms that have policies, the policies are of petty cash which states that when an employee needs a reimbursement they should sign a voucher which will be signed by a separate person before cash be issued. Business owners need to hire an accountant who can conduct the establishment of these policies and train the managers and employees about them. It is very important that firms make policies of internal control to avoid fraud, loss of assets, unauthorized use of assets (Flick, 2010).

#### Reasons that make Employees Breach Internal Controls in Place

Graph 3 below highlights the different reasons that might cause the employees fail to observe the internal controls in place.



**Graph 3: Reasons for Non-Observation of Internal Controls**

14(26.9%) respondents feel employees breach internal controls due to lack of training and knowledge followed by negligence 13(25.0%), 10(19.2%) feel breach of internal controls is due to lack of emphasis on controls and lastly three (5.8%) feel influence from seniors make employees to breach internal controls. From this, it could be concluded that training is a major move where owners could explore employees in internal controls.

### **Ways of Implementation of Internal Controls**

Respondents state that more training and emphasis on internal controls should be done to deter staff from breaching the internal controls. They also mentioned that strict laws and regulations are to be enforced on employees who breach internal controls, so that it could be a lesson to others who are intending to breach internal controls. If internal controls are violated policies should be changed provided internal controls do not remain the same as the previous ones (Campbell and Hatcher). Changing of internal controls requires consultations and this could get costly therefore employees should be closely watched and supervised so that they adhere to the internal controls. It is the management's responsibility to ensure that no infringement of internal controls occur (Laundes, 2007).

## Problems Facing Companies Regarding Internal Controls

Table No 5 below explains the problems that businesses face which are caused by having limited internal controls. These problems include misappropriation of assets, embezzlement of records and pilferage. Other was an option given to those respondents who did not experience the mentioned issues.

**Table 5: Problems Faced by Companies Regarding Internal Controls**

T below highlights selected problems that might be possibly experienced in small enterprises.

Item	Areas of exposure	
	No	%
Misappropriation of assets	18	34.6
Embezzlement of records	9	17.3
Pilferage	5	9.6
Other	3	5.8
Total	35	67.3
Missing system	17	32.7
Total	52	100

The most affected area in a lot of businesses is on the asset area. Misappropriation of assets 18(34.6%) seem to be posing greater risks than the other named problems. Followed by embezzlement of records nine (17.3%). Asset misappropriation occurs when assets of the company are being stolen and misused.

## Systems Available to Detect Problems Faced by Businesses

Respondents stated that they have a system to detect the problems faced by their enterprises. Those who choose embezzlement of records have not yet devised a procedure which ensures records are properly managed. Suggestions made were to keep proper records of documents checks. Invoices should be pre numbered systematically in order to avoid issues of duplication.

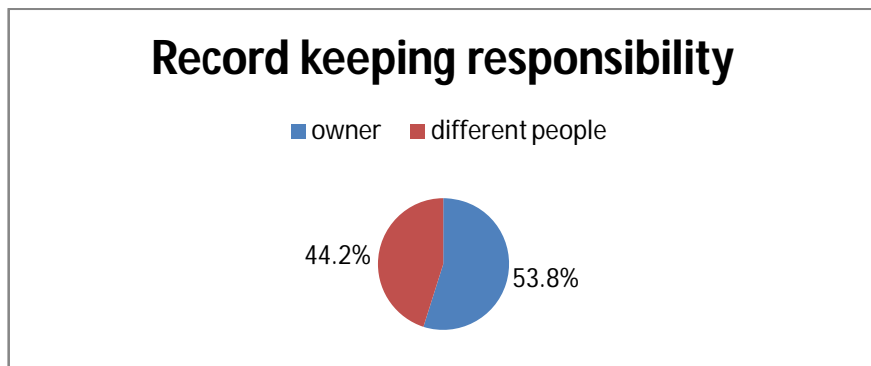
Misappropriations of assets are the major problem faced by most small firms. For the vehicles of the company track systems have been installed in the cars to ensure employees travel to the designated areas only. Regular stock takes and examination of equipment should be ensured.

Limited access to petty cash should be maintained to avoid lapping and kitting as well as avoiding to give one employee absolute control over one process for example authorization of sales. However, authors like (Davis) feel roles should be given to one employee so that when there is a problem it is traced back to that particular employee.

Companies which have experienced the problem of pilferage suggested installation of CCTV cameras and regular stock counts to know exactly the number of items in the stock bins. Regular changes to sales and purchases should be noted to ensure quick and fast responses to any deviations that may occur.

### Responsibility for Record Keeping

Graph 4 points out if there are separate people keeping the records or the business owners are the ones doing the record keeping.



**Graph 4: Record Keeping Responsibility**

The highest number of business owners, twenty eight (53.8%) keeps records for themselves. Twenty three respondents (44.2%) have another person to do the record keeping. People who keep their own records end up using the capital of the business to their personal benefits, eventually the business would fail (Thomola). Owners are duty bound to make sure they do not make any unnecessary drawings.

Businesses which stated that record keeping is done by a different person could have a separate person for keeping cash, record keeping and filling.

Segregation of duties is the most efficient technique in complying with the internal controls since it lowers the probability of two people making the same error and mistakes in processing transactions.

### **Government Regulations that Govern the Internal Controls in the Company**

Most of the small businesses have no government regulations that monitor their internal controls and they are not familiar with such regulations. Businesses that already pay value added tax (VAT) is governed by the Botswana Unified Revenue Services (BURS). With law firms Botswana Law Society seems to be insisting on proper internal controls through annual internal audits.

### **Relationship between Number of years for Operation and Problems Faced by the Business**

**Table 6: Cross Tabulation Showing Business and Problems faced by Businesses**

	Problems									
	Embezzlement		Misappropriation		Pilferage		Other		Total	
Business Size	No	%	No	%	No	%	No	%	No	%
Medium Scale	3	9	6	17	1	3	1	3	11	32
Small Scale	6	17	11		4	12	2	6	23	67
Total	9	26	17	49	5	15	3	9	34	100

Medium businesses are affected mostly by misappropriation of assets since it has a higher frequency of six (17%) compared to the others. Small businesses are also affected the most by assets misappropriation which is eleven (32%). Pilferage is the least experienced problem in both the small and medium enterprises.

### **Findings**

Thirty eight percent of small businesses have been operating for less than five years. This is due to lack of proper internal controls. This is in agreement with the study made by Bishop (2004) which states that small businesses get exposed to fraud and abuse. As a result, they are unable to survive hence failure to operate beyond five years. Internal controls have a role in managing resources of a business. T three and graph one shows that respondents agree that internal controls have an impact in managing the business resources and they believe internal controls are significant.

According to Campbell and Hatcher, small business owners should keep an eye on internal controls because they have a significant role in making sure that internal controls exist. Internal controls are rated in this research by most respondents as significant, in terms of their role in managing resources of the business. These ratings correlate with the study made by the Unicredit group which states that internal control protect the value of assets ([www.unicreditgroup.eu/en/govenace/internal-control-system.html](http://www.unicreditgroup.eu/en/govenace/internal-control-system.html)).

Respondents believe internal controls are moderately expensive to establish. Those who believe internal controls are less expensive might be because their businesses have auditors who perform exhaustive auditing (Arens, 2012).

Employees can get the knowledge of internal controls through in-service training, education, meetings and briefings. The mostly voted medium for learning about internal controls is training as showed by T four. Training gives employees a chance to acknowledge the efficacy of internal controls, and the desire to strengthen existing controls. (stony brook university). It is shown by graph three that employees breach internal controls because of lack of training and knowledge. There are other factors like influence from seniors, negligence and lack of emphasis on controls but lack of training is the mostly voted for. That means businesses should adapt training as way of guiding employees about internal controls.

There are various policies regarding internal controls examples include human resource, finance and risk assessment procedures. Human resource policies are important since reliable and honest employees yield better results relating to internal controls (e.g. reliable financial statements).

Problems facing small organizations are highlighted in T five with misappropriation of assets standing at the highest rate. Misappropriation of assets is a scheme of misusing, abusing and stealing business assets. This is in conformity of the ACFE 2008 report to the nation on occupational fraud and abuse which showed asset misappropriation as the leading problem affecting businesses. Management should always look for red flags like shortage in stock; an employee not willing to take day offs in order to identify problems mentioned in T five.

Record keeping as shown by graph four is mainly done by the owner. Authors like Spencer say that it is difficult to segregate duties in small businesses but it is advisable to have the duty of recordkeeping separate from authorizations, and keeping cash. This would avoid issues of theft, kitting and lapping (Arens, 2012).

Government regulations in Botswana state that the board of directors should review annually effectiveness of internal controls and report to shareholders. The implementation of these internal control guidelines should be submitted to the line ministries (Botswan Guardian, 2013). The banking act of 1995 gives Bank of Botswana authority to govern banking institutions in Botswana. The approach includes an analysis of the Bank records to determine whether bank has adequate resources and considers efficiency and adequacy of bank internal control. (Bank of Botswana at glance , 2007)

From the cross tabulation relationship shown in T six, most small businesses face a problem of asset misappropriation. Medium businesses also experience assets misappropriation the most then followed by embezzlement. Accountants should teach business managers about internal controls so they stay vigilant about any changes in the asset values of a company.

## **Conclusions and Recommendations**

Most of the findings of this research are satisfactory since they tally with literature review given by the scholar. However, this is not a true representation of all the business here in Botswana therefore generalizations about the findings should not be made.

From this research scholar found out that internal controls are moderately expensive to implement and that most businesses have internal controls as shown in Graph three. These findings do not correlate with the hypothesis number one for this research. Even though most small businesses have internal controls the owners cannot clearly explain how those internal controls are operating. This could be because of the complexity associated with internal controls hence owners have to hire an accountant or outsource the accounting services so they could learn more about internal controls (Long, 2009).



Small business owners are responsible for their own record keeping this might be because most of them are run by the owners themselves thus making them to be their own bookkeepers. It is in disagreement with the second hypothesis of the study because it indicates that owners are showing interest in the books. The record keeping that is done by one person (the owner) is in conformity with the hypothesis since record keeping is mainly done by one person. Modisane (2013) mentioned in the article by Stanbic Bank titled the challenges facing development of SMMEs in Botswana, that most small businesses are run by one person who is the owner. The owner can end up using the resource of the business for their own purpose.

The small business owners approached in this research are not aware of any government regulation that regulate the internal controls of a company. Only the law firms are well aware of such a regulatory body which is Botswana Law society.

## Recommendations

Small business owners should engage in training and for their employees on internal controls. They should be confident enough when it comes to controls because internal controls are vital to the success of a business. Small business owners amongst themselves in an area should organise workshops and seminars more frequently. This initiative would give them a platform to learn from each other about how to implement and follow the controls. As part of training, pamphlets and pens written about internal controls should be given to employees especially the newly employed. Incentives and appraisals should be given to employees who adhere to the internal controls.

Business owners should design the policies regarding internal controls which will act as a guide to follow internal controls. These policies should be easy to follow and should be changed every time there is a breach of internal controls.

Systems for detecting problems faced by small businesses (embezzlement of records, pilferage and asset misappropriation) should be put in place so that any occurrence of such matters is reported immediately. For instance the use of a track system in cars, it is always effective in showing the undesignated distance travelled by a car during the running of office errands.

Small business owners should attend workshops hosted by LEA, CEDA and get to learn about how they could successfully manage their businesses. This is where they could possibly learn about any government regulations that govern the internal control.

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