

I. Introduction

1. Study Background

The 1997 financial crisis in Asia exposed structural weaknesses in the banking and corporate sectors of affected countries owing largely to poor governance, lack of transparency, and weak supervision and regulation.⁸

The Asian Development Bank (ADB) has been taking a number of initiatives to assist Developing Member Countries (DMCs) in overcoming these structural problems. The focus on improved governance includes enhancing the effectiveness of public administration and development management at the sector level and in national institutions in the DMCs. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important prerequisites to an efficient financial structure.

Regional Technical Assistance (RETA) No. 5877 – *Strengthening Financial Management and Governance in Selected DMCs* – was approved by ADB for the purpose of carrying out initial studies to identify gaps and weaknesses in financial management and governance and to recommend courses of action to overcome these problems.

2. Objectives

ADB has demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. This RETA involved a diagnostic review of the existing accounting and auditing support, and standards in the selected DMCs. After carrying out this diagnostic review, the study assessed the need for assistance to improve the current situation. Objectives were to:

- (i) assess the capability and capacity within each country to provide efficient and effective accounting and auditing support to meet international standards and best practices, and address the issue of training and capacity enhancement

⁸ Zhuang, Juzhong, David Edwards, David Webb and Ma. Virginita Capulong. 2000. *Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand*. Asian Development Bank: Manila.

- (ii) determine the existing accounting and auditing standards of each country
- (iii) assess the degree of deviation from International Accounting and Auditing Standards (IAAS) while identifying weaknesses and possible corrective options
- (iv) discuss the fieldwork findings and introduce the concepts of the international standards through workshops
- (v) develop reference materials for potential users of the IAAS, and
- (vi) determine the level and type of assistance needed by each country in order to provide acceptable accounting and auditing support to the private and public sectors.

3. Scope

The RETA involved an in-depth study of the key issues relating to accounting and auditing support in the selected DMCs, identified gaps and weaknesses that need to be addressed to improve accounting and auditing support, and developed assistance programs in collaboration with other donors to rectify the identified weaknesses. Mongolia was one of seven countries that participated in the RETA.

4. Country Case Studies and Workshops

The first part of the study examined the current accounting and auditing structure and systems adopted in Mongolia. It also: (i) analyzed the political, institutional, and regulatory and legal framework on accounting and auditing practice, and the level of enforcement of existing laws, rules, and regulations; (ii) identified gaps and weaknesses in accounting and auditing support available and deviations from international standards; and (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

The second part of this study disseminated the findings of the country research through in-country workshops. Each workshop provided a cross-section of views on the findings of the research and established ways to move forward to improve financial management and governance in the country. After carrying out the assessment of accounting and auditing support in Mongolia, the study findings and recommendations were discussed at a workshop in Ulaanbaatar on 9 June 2000, and at an international conference at ADB Headquarters in Manila on 16-18 October 2000. This report incorporates feedback from

the workshop and the conference. Appendix 2 provides further information on the Ulaanbaatar workshop.

5. ADB Focus on Financial Governance in Mongolia

ADB has played an active part in helping the Government to define its role in the emerging market economy and improve governance through policy reforms and capacity building. The main objective of the new Country Operational Strategy for Mongolia is to foster economic growth and reduce poverty by focusing on income and employment generation through private sector development and promoting good governance as an overarching economy-wide objective for the strategy.

ADB has provided substantial technical assistance to Mongolia to develop accounting and financial management systems in key infrastructure sectors, and to improve legal and regulatory frameworks. Technical assistance has been provided to strengthen taxation and to improve accounting and audit systems. ADB is also supporting the Government's governance reforms through a program loan. These reforms involve the adoption of resource and performance-based accounting systems.⁹

6. Mongolia

Mongolia is a large (1.5 million km²), land-locked country located between two giant neighbors: Russia and the People's Republic of China. Mongolia's present population of 2.6 million people is growing at 1.4 percent. The national language is Mongolian; other languages spoken include Turkic, Russian, Chinese, and English. Ulaanbaatar, with a population of 650,000, is Mongolia's capital; other major cities include Darkhan (90,000) and Erdenet (65,000).

Located deep within the interior of eastern Asia far from any ocean, Mongolia has a marked continental climate, with long, very cold winters and short, cool to hot summers. Its remarkable variety of scenery comprises upland steppes, semi-deserts, and deserts, although in the west and north, forested, high mountain ranges alternate with dry, lake-dotted basins. Mongolia is highland country, with an average altitude of 1,585 meters above sea level.

⁹ Asian Development Bank. December 1999. *Country Assistance Plan: Mongolia (2000–2002)*.

Following independence from China in 1921, Mongolia became the second country after Russia to adopt communism in 1922. Mongolia remained closely tied to the Soviet Union until the end of the 1980s. It received technical, economic, and military assistance from the Soviet Union and generally followed Soviet guidance in political and cultural matters, both domestic and international. In the period 1990-92, however, Mongolia moved away from a monopoly of political power by the communist party to free multiparty elections, a coalition government, a new constitution, greater cultural and religious freedom with more emphasis on national Mongol traditions, and a neutral position in international relations, as well as towards some elements of a market economy.

Mongolia's major exports include copper, livestock, animal products, cashmere, wool, hides, fluorspar, and other nonferrous metals. Major imports are machinery and equipment, fuels, food products, industrial consumer goods, chemicals, building materials, sugar, and tea. Mongolia's major trading partners are Russia, China, Japan, South Korea and the United States. Mongolia's assets include abundant natural resources, a well-educated population, and a strategic trade location. It made sound progress in human development until 1990 after which progress stalled. Ninety-seven percent of the population is literate, compared to the average literacy rate of 49 percent in South Asia, and 53 percent in low-income countries worldwide.

Since 1990, Mongolia has embraced free-market economics, easing price controls, and liberalizing domestic and international trade. The severe climate, scattered population, and wide expanses of unproductive land, however, have constrained economic development. Economic activity traditionally has been based on agriculture and the breeding of livestock. In past years, extensive mineral resources had been developed with Soviet support; total Soviet assistance at its height amounted to 30 percent of GDP, but disappeared almost overnight in 1990-91. Economic growth picked up in 1997 and 1998 after stalling in 1996 due to a series of natural disasters and declines in the world prices of copper and cashmere. Real GDP growth in 1999 was estimated to be 3.5 percent. Mongolia's immediate challenges are reducing poverty and resolving the public sector imbalances that impede growth and promotion of private sector activity.¹⁰

¹⁰ Asian Development Bank. 2000. *Asian Development Outlook 2000*. p. 66.