

## VI. Government Budgeting and Accounting

This chapter describes government budgeting and accounting arrangements. For the purposes of this report, government is defined as Central and local government organizations. State-owned enterprises (SOEs) are covered elsewhere along with private sector organizations. The chapter is structured as follows:

- 1 – Introduction
- 2 – Legal Framework for Budgeting and Reporting
- 3 – Budgeting and Reporting Cycle
- 4 – Accounting Bases
- 5 – Financial Reporting
- 6 – Assets and Liabilities Management
- 7 – Accounting Information Systems
- 8 – Governance Reform Program
- 9 – Anti-Corruption Measures

### 1. Introduction

Mongolia has a high fiscal deficit. Transfers from the former Soviet Union, which provided between 30-40 percent of state revenues, dried up by 1992. The fiscal position gradually improved until 1998 when a series of external revenue shocks – for instance, dramatic falls in the price of key commodities, such as copper, cashmere, and gold – reduced associated fiscal revenues. Faced with this situation, a policy of cash rationing was adopted which was effective in the short term. This policy however, scared revenues into hiding and, consequently, the fiscal position has not improved even with the bounce back in commodity prices. On occasion in the past two years, the Government has run arrears on domestic and external debt payments and has had difficulty in meeting salary and pension payments.

Mongolia's public sector budgeting, accounting, and reporting arrangements represent a continuation of pre-transition central-planning systems. They are based on the Soviet model of accounting, which dictates prescriptive rules and requirements. The information provided meets the needs of central planning but does not provide the necessary information to support transparent, accountable or efficient government operations.

## 2. Legal Framework for Budgeting and Reporting

Three laws govern public sector budgeting and reporting. The *Law on Administrative and Territorial Units 1992* together with the *Law on Government 1993* set out structural arrangements and organizational responsibilities.

The *Budget Law 1992*, which is administered by MOFE, applies to state budgeting, the approval of the budget, the composition of budget revenues, allocation of budget funds, performance requirements, and reporting against budgets. The *Budget Law 1992* focuses on interactions between budget organizations. With the exception of broad categories of revenues and expenses, the *Budget Law 1992* is silent on reporting bases, disclosure requirements, and reporting formats.

## 3. Budgeting and Reporting Cycle

Mongolia's fiscal year is the same as the calendar year. The *Budget Law 1992* requires that:

- Draft budgets are submitted to the MOFE by 20 August.
- The MOFE submits the collated draft budgets to the Government (i.e. the Prime Minister and Cabinet Ministers) by 20 September.
- The Government must submit the collated budget to Parliament by 1 October.

An International Monetary Fund (IMF) report which, while three years old, remains current due to the absence of budgetary reforms, contended that:

“The present budget formulation process is driven from the bottom up rather than the top down ... The budget circular indicates expenditure limits to Ministries, and there is a prior calculation of limits for transfers from the central budget to the *Aimag*, but the process still relies heavily on ... prior year spending as a base for budget bids. This approach tends to entrench existing spending programs and gives little incentives for Ministries to seek economies or savings in their spending. To establish a greater discipline over the budgetary process it is necessary to place it properly within the government's desired macro-economic objectives and to set firm limits to the fiscal aggregates.”<sup>29</sup>

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<sup>29</sup> Allan, William, H. Bierman, and Rob Laking. January 1997. *Public Expenditure Management in Mongolia: Assessment and Proposals for Improvement*. IMF: Fiscal Affairs Department. p. 16.

#### 4. Accounting Bases

State-owned enterprises (SOEs) and the Bank of Mongolia are required to prepare financial statements in accordance with IAS. Government organizations currently use modified accrual accounting (revenues are rarely accrued due to budget financing arrangements). Aggregate government reporting is on a cash basis.

#### 5. Financial Reporting

##### Requirements and Formats

Government organizations are required to prepare two major financial statements which are submitted to the MOFE on a quarterly and annual basis: (i) the Balance Sheet and associated notes; and (ii) the Budget Performance Report. The contents and formats of these financial statements retain many of the characteristics of the Soviet accounting model and, as such, do not meet IAS requirements. Moreover, non-financial assets (e.g. inventories and physical assets) and some expenses (e.g. utilities) of government organizations are commonly reflected in the financial statements of other entities (e.g. The inventories, physical assets, and utility expenses of the MOFE are reported in the financial statements of “Building No. 5”). This issue of entity-definition undermines the ability of financial statements to “fairly reflect” an entity’s financial position and financial performance.<sup>30</sup>

##### Chart of Accounts

A standard chart of accounts is prescribed for use across government. However, the prescribed regulations are not always followed. For instance, the Financial Accounting Department of “Building No. 5”<sup>31</sup> introduced a new chart of accounts, in accordance with private sector accounting principles, in 1998. In contrast, the chart of accounts for Building No. 4 is still based on old principles, although the regulations, orders, and decrees for the operation of those principles were revoked in 1997.

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<sup>30</sup> Public Sector Performance (NZ) Ltd. April 1999. *Final Report on TA No. 2931-MON: Program Preparation for Governance Reforms: Status Assessment of Pilot Agencies* Volume III(3). p. 16.

<sup>31</sup> Buildings No. 4 and No. 5 are organizations in their own right for accounting purposes.

## Benchmarks, Ratios, and Covenants

There are no standard performance ratios or covenants issued as a benchmark for project or enterprise performance. Each project is considered on an individual basis and social and financial covenants are applied as a benchmark usually acting on advice of the donor in the case of foreign aid projects.

## 6. Assets and Liabilities Management

Government organizations assets were revalued on a regular basis until the early 1990s. The discontinuation of this practice in 1994 means that historical costs are mixed with revalued costs. Many assets are undervalued because of high inflation from 1990 to 1997. For instance, the whole of Building No. 4 (which would provide room for about 60 apartments) is currently valued at T3.5 million (\$3,500) while nearby ground floor apartments are selling for T20 million (\$20,000).

The assets of all government organizations were depreciated until 1994 in accordance with the *Government Resolution No. 8 (1993)*. The Resolution stipulated assets' useful lives, assets classes and depreciation rates. Depreciation has not been calculated since 1994. *Government Resolution No. 8 (1993)* provides a useful basis for fixed asset accounting, although some depreciation rates appear low (e.g., computers have an expected life of 12 years).

Assets are recorded in standard registers. The registers do not include details of location, purchase date or asset class. In addition, fixed assets are mixed with consumables, inventories and tools. There is no capitalization cut-off point; some recorded assets have values as low as T8 (\$0.0078). Furthermore, the asset registers are often poorly maintained.

Assets that have been transferred or donated from international projects and agencies are not reflected in the financial statements of government organizations. There is also poor physical control over the assets left behind from completed donor projects.

## 7. Accounting Information Systems

Manual accounting systems are employed in most government organizations. These manual systems are often supplemented by spreadsheets for reporting and analysis purposes. In addition, source

documents do not appear to meet the requirements of a modern accounting information system. The MOFE utilizes a computerized general ledger to monitor the receipts, expenditures, and commitments of each government organizations.

## 8. Governance Reform Program

### Introduction

In 1996 and 1997, the Government identified a number of problems with public sector arrangements. In response, a program was formulated to address issues with: (i) strategy formulation and resource allocation; (ii) budget execution; (iii) role clarity; (iv) performance objectives; (v) accountability for performance; (vi) accountability information; and (vii) inter-governmental accountability.

### Program Objectives

To address these issues, the Government developed a long-term reform program, the objectives of which are as follows:

Primary Objectives	Secondary Objectives
Improve Strategy Formulation, Strategic Resource Allocation, and Transparency, at the Aggregate Level.	<ul style="list-style-type: none"> <li>• Improve the process of government strategy formulation and resource allocation as reflected in the annual budget process</li> <li>• Improve the transparency surrounding the development and execution of government strategic and fiscal policy</li> <li>• Break the nexus between the political parties and the civil service thereby giving greater autonomy to the civil service while at the same time making it more transparent and accountable.</li> </ul>
Improve the Efficiency and Effectiveness of Service Delivery by Central Government	<ul style="list-style-type: none"> <li>• Introduce mechanisms which reward good performance and punish poor performance</li> <li>• Implement output-based budgeting in central government</li> <li>• Implement accrual budgeting and reporting for central government organizations</li> <li>• Implement a performance monitoring regime for general managers in central government</li> </ul>

## GOVERNMENT BUDGETING AND ACCOUNTING

Primary Objectives	Secondary Objectives
Improve the Management of the Government's Cash Flows and Financial Assets and Liabilities	<ul style="list-style-type: none"> <li>• Improve banking and cash flow management</li> <li>• Improve debt and investment management</li> </ul>
Improve the Performance of the State Enterprise Sector	<ul style="list-style-type: none"> <li>• Improve the accountability and transparency of the State enterprise sector</li> <li>• Improve the governance arrangements for state enterprises</li> </ul>
Improve the Performance of the Local Government Sector	<ul style="list-style-type: none"> <li>• Improve the arrangements of inter-governmental relations</li> </ul>
Improve Government Performance	<ul style="list-style-type: none"> <li>• Clarify Policy Development, Regulatory, Service Delivery, and Commercial Roles</li> <li>• Encourage privatization</li> </ul>

The essence of the program is captured in the draft *Public Sector Management and Finance* law that was submitted to Parliament in October 1997. In June 1999, the draft law received 78 percent support on its first reading. The following preparatory activities have been undertaken, concerning financial management:

Organization / Area	Description	Supported by
Public Administration Reform Project Team	Training in reform concepts, design and implementation. Preparation of: <ul style="list-style-type: none"> <li>• accounting policies (that conform to International Accounting Standards and International Public Sector Accounting Standards), financial-reporting formats, and guidance materials</li> <li>• employment guidelines</li> <li>• formats and guidance materials on the preparation of strategic business plans</li> <li>• cost accounting policies and associated guidance materials.</li> </ul>	ADB TA. 2868 ADB TA. 2931

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Organization / Area	Description	Supported by
Ministry of Finance and Economy	Support on budget-process design, training in PIP budgeting and training in the requirements of the new system.	ADB TA. 2931 Japan (JICA) World Bank Fiscal TA
State Audit Board	Institutional strengthening, training in the requirements of the new system and review of attest audits. Attest audits, in compliance with International Auditing Standards, completed of five pilot agencies. Overseas training for State Audit Board officials.	Germany (GTZ) ADB TA. 2931 World Bank Fiscal TA AusAID USAID
State Service Council	Training in the requirements of the new system (including remuneration setting and performance management).	ADB TA. 2931
Cabinet Secretariat	Training in the requirements of the new system.	ADB TA. 2931
Parliamentarians and Ministers	Study tours and seminars on the new system	ADB TA. 2868 ADB TA. 2931 UNDP NZODA AusAID
Management (including financial, human resource and planning)	Short-term focused training programs and assistance Medium-term academic courses The EU-TACIS Academy of Management training program is in the midst of introducing 1,500 public sector managers to modern public management practices.	ADB TA. 2931 UNDP TACIS World Bank Fiscal TA AusAID

## GOVERNMENT BUDGETING AND ACCOUNTING

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Organization / Area	Description	Supported by
Budgeting and Accounting	Training courses on financial accounting, management accounting, internal control systems, cash management. The initial phase of the UNDP training program has introduced public sector accountants to International Accounting Standards, cost accounting, financial analysis and public sector accounting. Tenders have been let for the provision of financial management information systems to support the reforms and the introduction of International Accounting Standards.	ADB TA. 2931 UNDP World Bank Fiscal TA

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In December 1999, ADB approved a \$25 million program loan, along with three technical assistance, to support the governance reforms.<sup>32</sup> The objectives of the governance reform program are to: (i) enhance aggregate fiscal discipline; (ii) improve public sector's budget formulation and execution; (iii) strengthen public sector's operational efficiency; (iv) address social impact of the reforms and the financial needs under the Program; and (v) prepare the groundwork for continuation of the reforms. The overall goal of the program loan and the accompanying technical assistance is to lay the groundwork for enabling a successful implementation of the whole spectrum of reform of the public sector in its entirety, while at the same time, ensuring that the system which is implemented is consistent with that designed.

### Adoption of International Public Sector Accounting Standards

The Government is in the early stages of adopting International Public Sector Accounting Standards (IPSASs) for budgeting and reporting. The Governance Reform Program involves the piloting of IPSASs in five selected agencies. In mid-1999, the State Audit Board (SAB), with the support of Victorian Auditor-General's Office (Australia), conducted a

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<sup>32</sup> Loan 1713-MON: *Governance Reform Program*, for \$25 million, approved on 2 December 1999.

review of the financial statements of two pilot agencies for which financial statements had been prepared. The reviewers commented that:<sup>33</sup>

“Based on the material provided by the Public Administration Reform Project (PARP) team, the knowledge of the Mongolian team members and the work performed during the assignment, a genuine attempt had been made at implementing the process of accrual accounting in the financial statements of the National Statistics Office (NSO) and the General Department of National Taxation (GDNT).

Based on the work performed, via the involvement of the PARP team and the SAB, a good start to the implementation process appears to have been made.

- a) The implementation process has taken several years in Victoria (Australia) and the first important steps in the process are now being taken by the Mongolian government. As such, the progress to date appears good, with high levels of commitment on the part of both the PARP and the SAB.
- b) The process of output [performance] measurement is one which in Victoria is only now being addressed some five or six years after the adoption of the model. However, based on the work performed on the two ... entities, a good attempt at output measurement has been made in the initial implementation phase of the project.
- c) In summary, the basic concepts contained within the proposed reporting framework have been applied to the financial statements of the two entities covered in the assignment.”

In May 2000, the SAB, with the support of the Victorian Auditor-General's Office, conducted a further review exercise of the other three pilot agencies. In 2000 and 2001, with the support from ADB, the five pilot agencies will prepare monthly financial statements, and forecast financial statements in accordance with IAS. Progress will be reviewed in 2001 with the intention of extending the exercise across the public sector.

To support the adoption of IPSAS in the public sector and to improve fiscal management, the MOFE is in the process of procuring a financial management information system with the support of a World Bank loan. The system will be piloted in five agencies then implemented across the wider public sector. At this stage, the MOFE has surprisingly

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<sup>33</sup> The review was undertaken by auditors from the Victorian Auditor-General's Office and was funded by AusAID.

opted to pilot the new system in different agencies from those under the ADB-supported governance reform program.

## 9. Anti-Corruption Measures

A recent study (1997-1998 data) of governance, that included anti-corruption measures, ranked Mongolia ahead of most of the former Soviet-influenced countries and all the other six countries being studied in this RETA (Figure 1 refers).<sup>34</sup>

However, anecdotal evidence indicates that corruption and associated activities have worsened significantly in the ensuing two years. For instance, a recent Survey of Businesses by the Chamber of Commerce found that 70 percent of businesses illegally evaded paying tax. Moreover, three Members of Parliament were convicted and jailed in 1999 for accepting bribes from a Macao company in relation to a casino license application. Corruption was a key issue in the July 2000 elections.

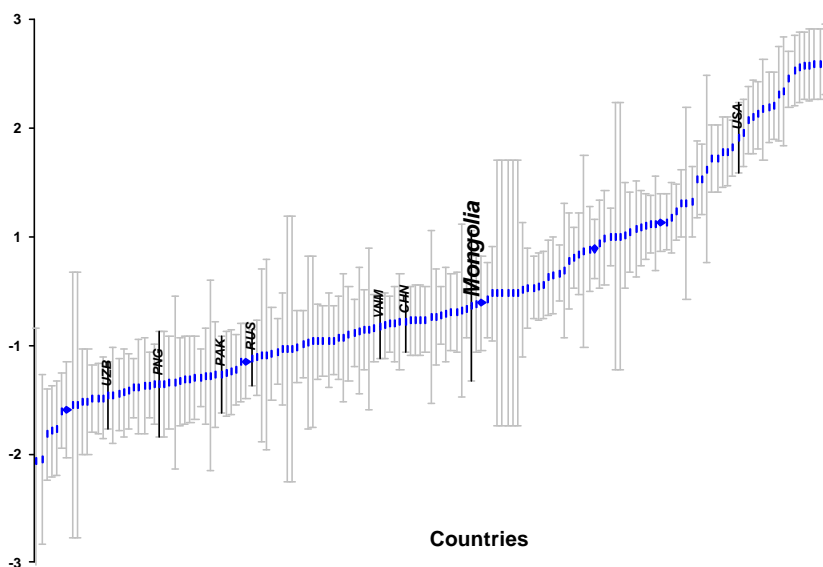
The *Anti-Corruption Law 1996* introduced some mechanisms to address corruption including: income and asset declaration requirements for politicians, cabinet members, some senior public servants, police, customs, and judicial officials. Income has to be declared within one month of their nomination or selection to one of these positions. On an ongoing basis, an annual declaration must be made in February of each year. A new anti-corruption law, currently before Parliament, seeks to strengthen these measures. The draft law has three components: (i) public education; (ii) legal environment; and (iii) institutional aspects including the establishment of a new office. It is intended that the *State Procurement Law 2000*<sup>35</sup> will improve the transparency of public sector procurement. Low state sector salaries are considered a key issue concerning corruption. Two key objectives of the public sector governance reform program are to: increase transparency and accountability in the public sector, and to increase the salaries of state servants by using the proceeds from efficiency gains.

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<sup>34</sup> Kaufmann, Daniel, Aart Kraay and Pablo Zoido-Lobaton. 1999. *Governance Matters*, Working Paper: The World Bank.

<sup>35</sup> ADB TA No. 3031-MON. *Development of Procurement Legislation and Guidelines*

Figure 1: Graft (Corruption) in 160 Countries



ADB's anti-corruption policy has three objectives: (i) supporting competitive markets, and efficient, effective, accountable, and transparent public administration as part of ADB's broader work in governance and capacity building; (ii) supporting promising anti-corruption efforts on a case-to-case basis and improving the quality of ADB's dialogue with its developing member countries on a range of governance issues, including corruption; and (iii) ensuring that ADB's projects and staff adhere to the highest ethical standards. ADB is making a significant contribution to anti-corruption measures through its support of the Government's public sector governance reform program. Other international donors, such as the UNDP, the Soros Foundation, and USAID are actively supporting other anti-corruption initiatives such as the new *Anti-Corruption Law*.

