

VIII. Issues and Recommendations

This chapter presents the issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements. The issues and recommendations are divided into two parts as follows:

- Part One. Where the matter referred to may be considered and, if any action were to be taken, this would be better achieved with external assistance.
- Part Two. Where the matter referred to may be considered and, if any action is to be taken, this may be achieved without the need for external assistance.

Part One. Where Donor Assistance Might be Appropriate

1. Institutional Arrangements

Introduction

Four key organizations are involved in the regulation and organization of Mongolian accounting and auditing arrangements: the Mongolian Institute of Certified Public Accountants (MICPA), the Mongolian Professional Accounting Council (MPAC), the Accounting Department of the Ministry of Finance and Economy (MOFE), and the Fiscal Policy Department of the MOFE. Table 9, on the next page, indicates that there are overlapping roles and responsibilities. Interviewees and workshop attendees questioned the effectiveness of these arrangements and particularly the MOFE's record of accomplishment in terms of setting accounting standards and providing training. The following subsections examine the institutional assignment of roles and responsibilities.

Certifying Accountants and Auditors

The process of certifying accountants involves setting certification criteria, preparing examinations, conducting examinations, grading examinations, evaluating practical experience, and approving qualifications.

Institutional arrangements should support high certification standards. The institution whose incentives are best aligned with this objective is MICPA (i.e. In contrast to government organizations, the

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President and staff of MICPA are accountable to MICPA members through the electoral process. It is thus in the interest of MICPA members that new members meet high qualification standards).

Table 9: Organizational Roles and Responsibilities

Roles and Responsibilities	MICPA	Ministry of Finance and Economy		
		MPAC	Fiscal Policy Department	Accounting Department
Certified Public Accountants				
Membership-based organization	✓	...	...	...
CPA Examination	Advisory	✓	...	...
CPA Candidate Training	...	✓	...	...
Granting and Recording CPA Titles	...	✓	...	...
Issuing Auditing Firm Licenses	...	✓	...	...
Professional Ethics				
• Drafting standards	✓	...	...	...
• Controls professional ethics	...	✓	...	...
Continuing Professional Education	✓	✓	...	...
Auditing Firm Licenses				
Receives and processes applications	...	✓	...	...
Recommends to Minister for Finance and Economy	...	✓	...	...
Maintains database of CPA firms	...	✓	...	✓
Accounting and Auditing Standards (Private Sector)				
Development	✓	✓	...	✓
Approval	...	...	...	✓
Dissemination	✓	✓	...	✓
Accounting Standards (Public Sector)				
Development	...	...	✓	...
Approval	...	...	✓	...
Dissemination	...	...	✓	...

Issuing Auditing Licenses

The process of issuing auditing licenses involves: setting criteria, examining applications, and approving applications. The process offers rent-seeking opportunities. The assignment of licencing responsibilities to an elected, representative body would counter these incentives.

Institutional arrangements should support high standards. As above, the organization whose incentives are best aligned with this objective is MICPA.

Training Responsibilities

The MOFE licenses accounting training organizations. This is presumably an attempt to encourage minimum standards, but there is no evidence of a market failure in this area that requires government intervention.

In addition, many public sector and private sector representatives questioned the MOFE's training role and record over the past five years in the course of the study fieldwork. Despite this, a recent report on public sector accounting training strongly recommends that the establishment of a specialized training center extend the training responsibilities of the MOFE.⁴⁶ In contrast, a program funded by the UNDP is currently training 1,600 public sector accountants in modern accounting concepts and practices. The program involved the development of a training curriculum and associated materials. Tenders were then called for provision of the training. Six providers were chosen, representing both private and public sector institutions. Preliminary anecdotal feedback indicates that the program is extremely effective.

Accounting Standard Setting

The issue of whether accounting standard setting should be a government or private sector function is faced by many countries. Mongolia has taken the former option. The view of some workshop attendees and many interviewees was that MOFE and MPAC have exhibited little aptitude for accounting standard setting.

⁴⁶ International Management Consultants Ltd. April 2000. UNDP Governance and Economic Transition Programme: *National Training Strategy for Public Sector Accountants*. UNDP MON/97/141.

In any case, if Mongolia were to adopt IAS without modifications, the standard-setting role would be relegated to that of education and information. Moreover, decisions on standard setting should reflect the views of financial statement users, and not necessarily accountants. In this respect, accounting standard setting would best be assigned to a statutory body, whose members are appointed from a variety of fields, and which is funded from the central budget.

MICPA Funding

In contrast with international practice, MICPA is not by law explicitly allowed to charge membership fees to individuals and to firms. This deprives MICPA of revenues that would otherwise be used to fund non-commercial activities, such as public information campaigns.

Proposed Institutional Arrangements

Based on the foregoing examination, the current organizational assignment of roles and responsibilities is sub-optimal. This report proposes that institutional arrangements be revisited and that roles be assigned to MICPA and a statutory body, such as an Accounting Regulatory Board (ARB). This would require the creation of the new statutory body, the disestablishment of MPAC, and associated legislative changes. These legislative changes would involve specifying the roles, rights and responsibilities of MICPA (for instance, the right to charge membership fees) and of the new statutory body.

Table 10: Recommended Organizational Roles and Responsibilities

Roles and Responsibilities	Organization		Funding Sources
	MICPA	ARB	
Certified Public Accountants (CPAs)			
Sets CPA qualification standards	✓	...	Examination & membership fees
Conducts CPA examinations	✓	...	
Grants and records CPA titles	✓	...	
Auditing Firm Licencing			
Receives and processes applications	✓	...	Application & annual license fees
Issues and revokes licenses	✓	...	

Roles and Responsibilities	Organization		Funding Sources
	MICPA	ARB	
Accounting and Auditing Standards			
Develops work plan	...	✓	Budget funding
Provides technical secretariat services	✓	...	
Reviews standards	
Approves and issues standards	...	✓	
Monitors enforcement	...	✓	

Institutional Recommendations

It is recommended that:

- **International Accounting Standards be adopted directly, without any modifications.**
- **A statutory body, the Accounting Regulatory Board (ARB), be created to promulgate accounting standards.**
- **MPAC be disestablished and its CPA examination and auditor-licensing functions be assigned to MICPA.**
- **The requirement to license accounting trainers be eliminated.**
- **Legislation is recast to reflect the above arrangements and to give MICPA legal status. This would ideally involve the amalgamation of the accounting and auditing laws.**

2. Resource and Reference Materials

There have been a variety of initiatives to translate or develop resource and reference materials on accountancy and auditing over the past decade. However, many interviewees and workshop attendees questioned the quality and availability of these materials. In particular, several accounting textbooks have been translated into Mongolian. The quality of some of these translations and the suitability of some of the selected materials (for the Mongolian environment) has been questioned. There have been also been at least five externally-funded projects to translate IAS into Mongolian in the past three years despite a 1994 report that “All these [International Accounting] Standards up to IAS 31 have already been translated into Mongolian.”⁴⁷

⁴⁷ Arthur Andersen. April 1994. *Strategic Plan for the Development of Accounting and Auditing Capability in Mongolia*. World Bank Project. p. 3.

Furthermore, sets of model sectoral financial statements, such as those that have been developed by International Accounting Firms, would be extremely useful practical reference materials for accounting and auditing practitioners.

It is recommended that a comprehensive review of Mongolian resource and reference materials should be conducted. The objectives of the review would be to:

- **identify all existing resource and reference materials, and**
- **review these materials for consistency, quality, and local applicability.**

It is also recommended that, following the review, the best of these materials should be selected and used as the basis on which to prepare excellent Mongolia-specific resource and reference materials. A particular emphasis should be placed on developing case studies and a series of model IAS-based financial statements.

3. Supervision of Bank Audits

In the face of numerous difficulties, the Bank of Mongolia has made progress in improving the supervisory regime for the banking sector. ADB has been a major supporter of these improvements.

The Banking Supervision Department of the Bank of Mongolia is responsible for licensing bank auditors and reviewing the financial statements of banks. The Department does not, however, have any qualified CPAs. Moreover, while staff recognize their shortcomings in this area, and are attempting to address them through self-study, there has been only one formal training initiative in International Accounting and Auditing Standards or on Reporting by Financial Institutions.⁴⁸

It is recommended that:

- **The Banking Supervision Department of the Bank of Mongolia recruit at least one qualified CPA.**
- **Personnel of the Banking Supervision Department of the Bank of Mongolia, together with bank accountants and finance directors, receive further training in International Accounting and Auditing Standards and Financial Reporting.**

⁴⁸ TA No. 2964-MON: *Improving Accounting and Auditing Systems II*. For \$688,000 approved December 1997.

4. Public Education on Financial Information

Lenders, creditors, investors, taxation authorities, policy makers, employees, pressure groups, and the public rely on financial information. Users who understand what is good, and what is bad, financial information will create demand for improved financial governance. Research shows that the successful introduction of financial reporting based upon International Accounting Standards is heavily reliant on user understanding – not just on the competence of the preparers of financial statements.

The public education initiatives that are being supported by MICPA and USAID are worthy of attention. MICPA sponsors a limited public education campaign from its small budget. USAID supports the publication of newspapers and the development and broadcasting of television serials.

It is recommended that:

- **Public education initiatives on the nature and uses of financial information should be continued and broadened.**
- **A short leaflet be prepared that describes the purpose and methodology of audits, and what users should look for when reading financial statements.**

5. Professional Supervision of CPA Firms

The Mongolian CPA profession is in its infancy and the quality of services provided by accounting firms ranges from poor to very good. The implementation of an effective professional supervision regime would lift standards and eliminate less competent firms from the market.

It is recommended that a project to improve professional supervision be undertaken. The project would involve:

- **studying the existing structures and processes of CPA firms,**
- **examining, and drawing useful lessons from international experience with regards to supervisory regimes (including peer-review regimes),**
- **designing a supervisory system for Mongolia that takes account of the local situation and provides sufficient flexibility to deal with environmental changes,**

- **reviewing and, where necessary, revising CPA legal responsibilities and associated disciplinary regulations,**
- **implementing the supervisory system and associated reporting systems, and**
- **improving the competence and effectiveness of managers with supervisory responsibilities through training.**

6. Continuing Professional Education (CPE) for CPAs

MICPA is currently considering options for CPE requirements and delivery of CPE. They have requested assistance to develop the CPE system.

It is recommended that a project to develop a sustainable compulsory Continuing Professional Education (CPE) System for CPAs be undertaken.

7. MICPA Membership Categories

MICPA has one individual membership category – that of the CPA. It is common international practice for professional bodies to have a range of membership categories with different qualification criteria (e.g. Accounting Technician).

The establishment of at least one subsidiary membership category within MICPA would provide a transitional route for aspiring CPAs and a professional body for lower level accountants. It would also provide a way of reclassifying accountants who had qualified as CPAs before 1997.

In addition, while MICPA's members include public sector accountants, the Institute does not have a separate public sector membership category. The establishment of a public sector membership category within MICPA would provide public sector accountants with a professional organization, improve their societal status, and improve their knowledge and competence. It would also increase MICPA's membership and revenue base, and unify the accountancy profession.

It is recommended that MICPA should:

- **Establish subsidiary membership categories – at least for accounting technicians.**
- **Establish a new category of membership for public sector accountants and develop appropriate entry criteria.**

8. Countryside Training

The MOFE and MICPA estimate that there are around 18,000 'accountants' (bookkeepers) in the countryside (i.e., outside Ulaanbaatar). This group has received limited training in modern accounting and financial management.

It is recommended that:

- **A project be developed to train a selection of countryside accountants in modern accounting and financial management.**
- **100 accountants be trained in each of the 21 *Aimags* (provinces).**
- **The training be practical in that it involves the conversion of two enterprises in each *Aimag* to International Accounting Standards.**
- **The exercise then be extended to the remaining 'accountants' and enterprises in each *Aimag*. This would involve the trained accountants working with a central team.**

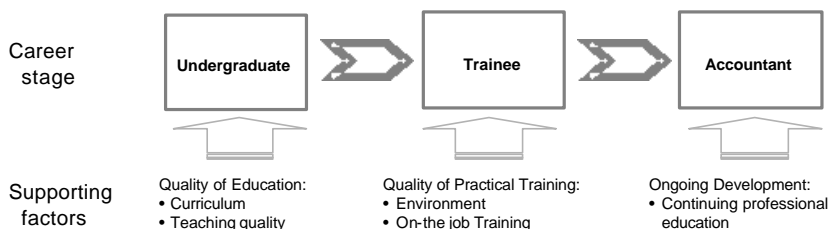
9. Training for Accounting Lecturers and Professors

A model tertiary accountancy curriculum has been developed with ADB assistance and adopted by tertiary institutions.⁴⁹ The curriculum reflects the three major components of an acceptable degree program, and includes semester-by-semester listings of courses, including the academic units for each semester. To this end, accounting lecturers and trainers recently held a conference to discuss progress in introducing the uniform curriculum.

There is no specific advanced training provided for the continuing education of accounting lecturers and professors in Mongolia. In order to develop competent accounting graduates, the trainers themselves must be thoroughly conversant with modern-day practices and trends. The quality of undergraduate teachers is a key factor in developing competent accountants (Figure 2 refers).

⁴⁹ TA No. 2964-MON: *Improving Accounting and Auditing Systems II*. For \$688,000 approved December 1997.

Figure 2: Developing Competent Accountants



It is recommended that:

- **A specific training program for accounting professors and lecturers be developed and implemented. This training program should include present day best practices in accounting procedures and current information available on International Accounting Standards. Important matters such as information technology (including both hardware and software) should also be included.**
- **A professional organization be established in order that accounting professors and lecturers may further their education and share their technical knowledge through a common forum.**

Part Two. Where External Assistance is Not Required

10. Improving Audit Quality through Legislative Changes

Mongolian legislation requires that quarterly financial statements be prepared and audited within very short timeframes. This undermines the status of auditing and devalues the role of the independent audit. This section describes this situation and recommends improvements.

Mongolia’s move to a market economy created demand for accounting and auditing services. The following factors heighten demand:

- All private and public sector organizations must have a balance date of 31 December, with no exceptions are allowed.
- Financial statements must be prepared and certified quarterly by the **20th day** following the end of the quarter and submitted to the General Department of National Taxation.
- Annual financial statements for the year ended 31 December must be prepared, audited, and submitted by 10 February of the following year (i.e., within **41 days** of the end of the year).

A proper audit simply cannot be conducted in these timeframes – whether in Mongolia or any other country. Moreover, as all organizations are on a 31 December balance date, these requirements create audit bottlenecks that must further lessen audit quality.

Professionally competent CPAs are the product of years of specialized education, on-the-job training, and practical experience. There are two supply-side options available to quickly increase the availability of CPAs:

- First, CPA skills can be imported through the services of foreign accountants. However, while Mongolia's domestic accounting market is open to entry by foreign accounting firms, only one such firm (Arthur Andersen) has established permanent operations. Other international firms have had a transitory presence due to the small market size, general operating constraints on foreign firms (e.g., taxation arrangements), fee constraints, and competition from domestic CPA firms, which do not arguably meet international quality standards.
- Second, professional admission criteria can be lowered to increase the supply of certified accountants. Mongolia has implicitly taken this approach:
 - Before the adoption of the *Auditing Law 1997*, CPA certificates were granted based on questionable subjective criteria (largely based on accounting experience gained in the central-planning environment). These certificates holders have not had to be re-certified.
 - The *Auditing Law 1997* requires that accountants must pass a three-stage examination and demonstrate suitable practical experience before they are granted a 'permanent' CPA title. In practice, the CPA title is conferred once the first examination is passed.
 - In 1998 and 1999, 34 carefully screened candidates sat international standard CPA qualification examinations. Eighteen of these candidates received a full pass and eight received a conditional pass.⁵⁰ Some of the candidates who failed the examinations were already qualified Mongolian CPAs. This indicates quality differences between the Mongolian CPA criteria and International CPA criteria.

⁵⁰ ADB TA No. 2964-MON: Improving Accounting and Auditing Systems.

The increased demand for accountants has made accountancy a career choice for many young Mongolians. This is reflected by the number of private sector training institutions that have been established in response to this demand. In the medium to long term, market forces will work to ensure that a balance is achieved between the demand for accountancy services and an adequate supply of professionally competent CPAs able to provide these services. However, in the short to medium term, there are not enough professionally competent accountants in Mongolia to meet legislated demands. Professional standards have been maintained at low levels in an effort to ensure that these demands are met. Even so, only 500 of Mongolia's 30,000 organizations have fully implemented IAS and, of the 440 businesses listed on the Stock Exchange, public accounting firms are auditing only 80 percent.

The following options would dramatically reduce peak demand for auditors:

- Quarterly Certifications. The quarterly certification is required for taxation purposes. This requirement should be eliminated as feedback from interviewees indicates that the process is little more than a “rubber stamp” for which auditing firms earn revenue. If the process is not removed, then the following options should be considered:
 - The certification process should be defined as being a limited numerical review that does NOT constitute an audit,
 - The allowable timeframe for certifications should be extended from 20 days following the quarter-end, to at least 60 days following the quarter-end.
- Annual Audits. Two factors reduce the quality of annual audits: (i) the universal 31 December balance date; and (ii) the allowable timeframe (41 days). The following options should be considered:
 - The *Accounting Law 1993* requirement of a universal 31 December balance date should be amended to allow alternative balance dates for financial reporting,
 - The allowable timeframe for annual audits should be extended from 41 days following balance date to at least 120 days following balance date.

It is recommended that legislation be amended as follows:

- **to completely remove the requirement for quarterly certifications of financial statements;**
 - OR –
- **to define the quarterly certification process as being a limited numerical review which does NOT constitute an audit, and**
- **to increase the allowable timeframe for submission of “certified” financial statements from 20 days following the end of the quarter, to at least 60 days following the end of the quarter.**

It is also recommended that:

- **the *Accounting Law 1993* be amended to allow alternative balance dates for financial reporting (i.e., other than 31 December).**
- **the *Auditing Law 1997* be amended to increase the allowable timeframe for annual audits from 10 February (i.e., 41 days following balance date), to at least 120 days following balance date.**

11. Recognition of Public Sector Accounting Policies

A comprehensive set of public sector accounting policies has been developed as part of the ADB-supported Governance Reform Program. These accounting policies are consistent with International Public Sector Accounting Standards (IPSASs) and IAS. Moreover, they have been successfully applied to the financial statements of the five pilot agencies. The MOFE does not recognize these accounting policies.

It is recommended that the Fiscal Policy Department of MOFE officially recognize the accounting policies that were developed and applied under the Governance Reform program.

12. Granting of CPA Certificates

CPAs must sit and pass a three-stage examination, and demonstrate suitable practical experience, before they are granted a 'permanent' CPA title. However, the *Auditing Law 1997* permits accountants to conduct audits as soon as they have passed the first CPA examination. This devalues the credibility of the CPA title and reduces audit quality. Furthermore, ADB provided significant technical assistance to train a small group of accountants to international standards.⁵¹ Eighteen of

⁵¹ ADB TA No. 2964-MON: *Improving Accounting and Auditing Systems*, for \$688,000 approved in December 1997.

these accountants passed an international-standard CPA exam in 1999. Despite having qualified to international standards, these accountants have not received their CPA certificates due to a questionable legal opinion from the MOFE. This brings into question the effectiveness of providing this assistance.

It is recommended that the *Auditing Law 1997* be amended so that:

- **The CPA title is granted only when an accountant completes the third examination and has acquired suitable practical experience.⁵²**
- **A new accounting title is created, for instance provisional CPA or registered accountant for those accountants who have not passed the final examination.**

It is also recommended that the 18 accountants who passed the international-standard CPA qualification be granted their certificates without further delay.

13. Reclassification of CPA Titles

Many Mongolian CPAs qualified under reduced criteria during the period from 1993 to 1997. Understandably, those 'CPAs' who qualified under the earlier criteria would not want to lose the title. One partially, acceptable solution would be to create a new accountant category, for instance 'registered accountant' for this group of accountants. Another would be to require re-qualification by a future date (e.g. three years).

It is recommended that either:

- **all CPA titles granted under the old 1993-1997 regime be reclassified as 'registered accountant' titles.⁵³**
– OR –
- **all CPAs who qualified before 1997 should be required to meet the current membership criteria within three years. If not, their CPA title should be revoked.**

⁵² In accordance with the recommendation in the following report: Arthur Andersen. April 1999. Final Report: ADB TA No. 2964-MON: *Improving Accounting and Auditing Systems*. Page 24.

⁵³ In accordance with the recommendation in the following report. Arthur Andersen. April 1999. Final Report: ADB TA No. 2964-MON: *Improving Accounting and Auditing Systems*. Page 26.

