Financial Management and Governance Issues in Mongolia

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Foreword

This report describes financial management and governance arrangements in Mongolia, identifies deficiencies in those arrangements, and presents recommendations to address those deficiencies. For the purposes of this study, financial management and governance arrangements are narrowly defined as being accounting and auditing arrangements and practices.

The report was prepared for the Asian Development Bank (ADB) by Barry Reid (International Consultant) with overall guidance from Francis B. Narayan (Lead Financial Specialist, ADB) under Regional Technical Assistance (RETA) 5877 – Strengthening Financial Management and Governance in Selected Developing Member Countries. G. Tserenkhand and D. Bayasgalan provided able research assistance. The contents of the draft report were discussed and debated with representatives from the Government, the private sector, and international organizations at a workshop held in Ulaanbaatar on 9 June 2000. The issues and recommendations were further discussed at an international conference at ADB headquarters in Manila on 16-18 October 2000.

This report should be read in conjunction with the Summary Report, which identifies and examines selected issues in relation to financial management and governance.1

The authors would like to offer their appreciation to the numerous officials, researchers, and agencies that gave up their valuable time and made materials available during the course of the research. In particular, we would like to thank: Barry Hitchcock (Resident Representative, ADB Mongolia Resident Mission) for his ongoing support; Dr R. Batjargal (Head of Accounting and Auditing Department, Ministry of Finance and Economy), for chairing the Ulaanbaatar workshop; David Edwards (Assistant Chief Economist, Project Economic Evaluation Division, ADB), for moderating the Manila conference session at which this report was discussed; and Dr L. Dondog (President of the Mongolian Institute of Certified Public Accountants) and B. Bolormaa (Accounting Specialist, Ministry of Finance and Economy), for their involvement in the study and their representation at the Manila conference.

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Currency Equivalents
(as at 4 November 2000)

Currency Unit – Togrog (T)

T 100 – $0.00091
$100 – T 1,096

The value of the Togrog has been determined using a floating exchange rate since May 1993.

Abbreviations

ADB Asian Development Bank
BOM Bank of Mongolia
CPA Certified Public Accountant
CPE Continuing Professional Education
GDP Gross Domestic Product
IAS International Accounting Standard
IFAC International Federation of Accountants
IMF International Monetary Fund
IPSAS International Public Sector Accounting Standard
MICPA Mongolian Institute of Certified Public Accountants
MOFE Ministry of Finance and Economy
MPAC Mongolian Professional Accounting Council
PARP Public Administration Reform Project
PIP Public Investment Program
RETA Regional Technical Assistance
SAB State Audit Board
SAI Supreme Audit Institution
SOE State-owned Enterprise
TA Technical Assistance
UNDP United Nations Development Program

Notes

(i) The financial year of all organizations, including the Government, ends on 31 December.

(ii) In this report, $ refers to US dollars.
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Executive Summary

Background
Following independence from China in 1921, Mongolia became the second country after Russia to adopt communism in 1922. It remained closely tied to the Soviet Union until the end of the 1980s. In the period 1990-92, however, Mongolia moved away from a monopoly of political power by the communist party to free multiparty elections, a new constitution, and greater cultural and religious freedom with more emphasis on national Mongol traditions, as well as toward some elements of a market economy. Mongolia's transition to a market economy, which began in 1990, has proceeded satisfactorily, and the private sector is now the main producer of goods and services.

Mongolia's severe climate, scattered population, and wide expanses of unproductive land, 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 Gross Domestic Product (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 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 are the main barriers to growth and promotion of private sector activity.²

Challenges and Responses
Mongolia had no accounting infrastructure before 1922 when it adopted the communist system. Mongolia developed its accounting systems in parallel with the Soviet Union throughout the 1920s and 1930s. The ‘Soviet accounting system’ catered to the needs of central planning – in particular, the system provided statistical information, including financial information. It emphasized standardization and uniformity so that information could be compared across sectors and industries. Detailed instructions negated the need for professional judgment in the accounts-preparation process. Consequently, public accounting firms and an accountancy profession were never necessary.

Mongolia's rejection of communism in 1990 placed it in the same position as other Soviet Bloc countries concerning accounting arrangements. However, the Soviet accounting system created a sound basis on which to build. First, the system used many concepts of modern accounting including accrual measurement and double-entry bookkeeping. Second, large numbers of bookkeepers were trained in these concepts and were proficient in their application.

In the decade since the beginning of the transition, Mongolia has made reasonable progress in terms of developing an accounting infrastructure suitable to the needs of a market economy. In particular, a competent professional accountancy institute has been established, and, in broad terms, the legislative framework for the accountancy profession is sound.

**Accounting and Auditing in Mongolia**

The Ministry of Finance and Economy (MOFE) administers the Accounting Law 1993, which regulates the maintenance of accounting records and the preparation of balance sheets by business entities and organizations in both the private and the public sectors. It also sets out financial reporting requirements, which require that the Minister for Finance and Economy must approve standard accounting forms and methods for business entities and organizations. The Accounting Law 1993 requires that accounting standards must be consistent with International Accounting Standards (IAS). Financial statements are required to 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.

Auditing in the Soviet Bloc, including Mongolia, reflected the highly prescriptive nature of the underlying accounting system. It was primarily a verification exercise, with the final accounts being compared to the bookkeeping records by accountants from another enterprise within the same group. It is not surprising that a fully functioning and competent audit profession has not been created within the short time frame of 10 years. For instance, of the 440 businesses listed on the Stock Exchange, public accounting firms are auditing only 80 percent. The Auditing Law 1997 is administered by the MOFE and the Mongolian Professional Accounting Council (MPAC) and
applies to the determination of auditing principles, administration of the process for registering auditing companies, and the process for granting Certified Public Accountant (CPA) qualifications. The Auditing Law 1997 requires that licensed audit companies must conduct audits. The Minister for Finance and Economy is responsible for approving applications for licenses and relies on the recommendation of the MPAC. Qualified CPAs must staff audit companies.

As its name implies, the State Audit Board (SAB) is responsible for conducting public sector auditing. The SAB is Mongolia's Supreme Audit Institution (SAI) and was established in 1995. The State Audit Law governs the operations and responsibilities of the SAB. The Chairman of the State Audit Board (the Auditor-General), and its eight other senior members, are appointed by, and report directly to, Parliament. Mongolia has 41 registered public accounting firms of which Arthur Andersen is the only representative of the large international accounting firms.

**Professional Infrastructure**

Because of Mongolia's state of development before 1922, and the ensuing seven decades of communism and central planning, Mongolia had no accountancy profession before 1992. In 1993, the National Association of CPAs was established and became the Mongolian Institute of Certified Public Accountants (MICPA) in March 1996. Three bodies are involved in the regulation and organization of Mongolia's accountancy profession: MICPA, MPAC, and the Accounting Division of the MOFE. The Accounting Law 1993 gave MPAC the authority to administer the professional accounting examinations that qualify accountants as CPAs. MPAC administered the inaugural CPA examinations in July 1993, but these examinations were prepared and graded by non-CPAs. The syllabus, on which candidates were examined, did not include auditing. So, those CPAs who qualified between 1993 and 1997 did so under low criteria. The Auditing Law 1997 tightened up the process for granting CPA titles and requires that accountants pass a three-stage examination. CPAs do not have to meet continuing professional education requirements to retain the title.

MICPA had 366 members as at 31 December 1999. Females and males are represented equally; 116 members worked in the public sector (Central Government, local government, and State enterprises), the other 250 worked in the private sector. Excluding honorary
memberships (of which there are two), MICPA has only one membership category – that of CPA.

**Accounting and Auditing Standards**

Three organizations contribute to the development of private sector accounting standards: the Accounting Division of MOFE, MPAC, and MICPA. There is however, no formalized process for development, exposure, approval, and promulgation. Rather, drafts are circulated around selected organizations for comments.

Mongolian accounting standards are an integral part of a ‘uniform accounting system’ – based upon the former Soviet accounting system. In this respect, detailed accounting instructions and reporting formats are issued, of which accounting standards are an integral part. The accounting instructions also include taxation requirements. There are few differences between the ‘Mongolian Accounting System’ and IAS. The Fiscal Policy Department of MOFE has recently assumed responsibility for developing and promulgating accounting standards for public sector reporting. In 1998, as part of the Public Administration Reform Project, accounting policies were developed based on International Accounting Standards (IAS) and the (then unreleased) International Public Sector Accounting Standards (IPSAS).³

The Auditing Law 1997 requires that auditors apply International Standards on Auditing (ISAs). Consequently, Mongolian auditing standards are a direct translation of ISAs.

**Education and Training**

Communism has left Mongolia with a legacy of high educational standards – particularly in the sciences – on which to build. Like many other countries in transition, Mongolia has a very large number of ‘accountants’. The MOFE estimates that there are 4,000 to 5,000 public sector accountants and around a further 30,000 private sector accountants. In reality, most of these accountants are bookkeepers and producers of statistical information. Mongolia has moved away from the Soviet educational model in the past 10 years. Before 1991, accountancy was not taught as a major in universities and colleges. Five state institutions now offer undergraduate and postgraduate programs

³ ADB TA No. 2931-MON: Program Preparation for Governance Reforms, for $967,000 approved December 1997.
in accountancy but, as these institutions are unable to meet demand, a number of private-sector accountancy training providers have emerged.

A recent United Nations Development Program (UNDP) study identified the following issues with respect to tertiary training:

(i) Teaching aids – the blackboard is the prime teaching tool due to budgetary constraints; (ii) Textbooks – there is a shortage of Mongolian textbooks, in terms of both quantity and range. Moreover, the quality of these texts is poor in terms of translation and their application to the Mongolian environment; (iii) Staff development – the faculty members that were interviewed in the UNDP study acknowledged that their accounting knowledge and skills base could be improved, but financial constraints limited further study opportunities; (iv) Teaching methods – these focus on the traditional lecture approach. To an extent, this is due to accounting lecturers being paid based on hours taught. Not only does this compromise learning effectiveness but lecture hours are very high at the expense of tutorials and research; (v) Academic association – accountancy lecturers do not have an association; and (vi) Training for academics – accountancy lecturers do not receive targeted training.

Government Budgeting and Accounting

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 that 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. State-owned enterprises (SOEs) and the Bank of Mongolia are required to prepare financial statements in accordance with IAS. Government organizations use modified accrual accounting – aggregate government reporting is on a cash basis.

In 1996 and 1997, the Government identified a number of problems with public sector arrangements. In response, a program was formulated to address problems with: strategy formulation and resource allocation; budget execution; role clarity; performance objectives; accountability for performance; accountability information; and inter-governmental accountability. In December 1999, ADB

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approved a $25 million program loan, along with three technical assistances, to support the governance reforms. 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 assistances 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.

**Donor Assistance**

Three ADB program loans are directly related to supporting improved financial management and governance arrangements. First, the Financial Sector Program Loan I\(^5\) supported strengthening of the banking system, including the legal and regulatory framework. Second, the Financial Sector Program Loan II\(^6\) is intended to further strengthen governance arrangements in the sector, including further attention to legal and regulatory deficiencies. Finally, the Governance Reform Program loan is intended to support the Government’s intention to pilot administrative reforms, including the adoption of IAS-based accounting, in five government agencies.\(^7\) Furthermore, directly relevant TA projects include:

- TA No. 2390-MON: Improving Accounting and Auditing Systems ($600,000: 1996–1997). The activities under this TA included: preparing a training manual for accountants; preparing an auditing manual; developing a draft audit law; assisting the establishment of a national accounting profession (e.g., articles of association, by-laws, and code of ethics); and developing and delivering a training program on financial accounting, managerial accounting, and

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5 Loan 1509-MON: Financial Sector Program, for $35 million, approved on 16 December 1996.
6 Financial Sector Program II, for $15 million.
7 Loan 1713-MON: Governance Reform Program, for $25 million, approved on 2 December 1999.
accounts conversion. Additional courses on accounting information systems and auditing were also developed and delivered.

- **TA No. 2931-MON: Program Preparation for Governance Reforms ($967,000: 1998–1999).** This TA had three aspects: assisting the Government prepare the inputs for a possible Program loan on governance reforms; assisting in the development, refinement and communication of draft legislation (the Public Sector Management and Finance Law); and supporting the groundwork for the implementation of the reforms arising from the enactment of the draft legislation. With respect to the third aspect, this involved developing accounting policies and accounting guidelines for the public sector based upon International Accounting Standards (IAS) and International Public Sector Accounting Standards (IPSASs). It also involved assisting five pilot agencies to prepare annual financial statements based on these financial policies.

- **TA No. 2964-MON: Improving Accounting and Auditing Systems II ($688,000: 1997–1998).** The activities under this TA included: preparing 34 accountants for international standard CPA examinations and conducting these examinations (18 candidates passed the examinations), providing accountancy textbooks in Russian and Mongolian, and assisting MICPA.

- **TA No. 3316-MON: Initial Phase of Public Administration Reform ($700,000: 2000–2001).** The broad objectives of this TA are to move five pilot agencies to output-based budgeting. As part of this process, accrual-based budgeting and reporting will be entrenched in five organizations.

The **World Bank** approved the Fiscal TA Project for $5 million in June 1998. The intention of this project is to support the development of an efficient and transparent government financial management system, and the introduction of a value-added tax to strengthen the government’s revenue base. The Fiscal TA Project will provide funding for: computerized government financial management information systems (including debt, cash, treasury management, whole-of-government consolidation, and organizational accounting); training in management development; training in accrual accounting, and budgeting; and development of attest auditing capacity. An earlier project, the Accounting Development Project, was implemented from July 1993 to September 1994. The project had the following aspects: converting the accounting systems of three State-owned enterprises to IAS; developing
a strategic plan for improving accounting and auditing system; updating the accounting curricula for universities; and providing training in financial and management accounting for accountants of major SOE and tertiary institutions.

The **UNDP** is involved in financial governance issues through its Program for Accountability and Transparency (PACT). The Accounting Training Project ($76,000; 1999–2000) has involved the development and delivery of a training program to finance staff in government organizations (focusing on the requirements of the new public administration system). The **IMF** has provided three Technical Assistance on public expenditure management, although these TAs have not directly involved accounting or auditing. **AusAID** (Australia) is providing support to the State Audit Board in association with the ADB-supported governance reform program. **JICA** (Japan) is supporting the design and implementation of a Public Investment Program (PIP) Budgeting Process in the Ministry of Finance and Economy through the provision of consulting advice and training (1998–2001). **EU-Tacis** (European Union) is supporting the Academy of Management (AOM) to improve the effectiveness and efficiency of public administration through provision of short- and long-term training of public administrators. **GTZ** (Germany) is providing support to the State Audit Board through a project titled Institutional Strengthening of the State Audit Board (DM 3 million: 1998–2001). The Project aims to improve state auditing (methodologies and technical skills) by providing equipment, training and short-term experts. Its project involves training (seminars and study tours) for staff from the SAB, MOFE and AOM.
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.

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

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(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 (15 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.

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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

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II. Accounting and Auditing in Mongolia

This chapter presents an overview of accounting and auditing arrangements in Mongolia. It provides context for the following chapters on professional infrastructure, accounting and auditing standards, accounting and auditing training, and government budgeting and accounting arrangements. The chapter comprises twelve sections, in two parts, as follows:

Part One: Accounting
1. Introduction – identifies historical factors that have influenced Mongolian accounting arrangements.
2. Issues and Responses since 1990 – examines the issues that faced Mongolia in 1990 when the transition process to a market economy began. It also summarizes the actions that were taken in response to these issues.
3. The ‘Mongolian Accounting System’ – describes accounting arrangements. These include governing laws and regulations, accounting bases, asset management and internal-control systems, and accounting information systems.

Part Two: Auditing
5. Introduction – discusses the historical backdrop to the development of modern auditing arrangements in Mongolia.
6. Governing Laws and Regulations – describes the laws that govern Mongolian auditing practices and audit requirements.
7. Audit Requirements – describes the requirements for organizations to be audited.
8. Auditor Qualifications – describes auditor qualification requirements.
9. The State Audit Board (SAB) – describes the role and functions of the SAB, which is responsible for conducting public sector audits.
10. Public Sector Auditing Issues – identifies issues which complicate the public sector auditing process.
12. Public Accounting and Auditing Firms – describes the presence of domestic and international accounting firms in Mongolia.
Part One. Accounting

1. Introduction

Despite having been pioneers of some major economic advances – for instance, Kublai Khan introduced paper money to the world in the 1300s – Mongolia had no accounting infrastructure before 1922 when it adopted the communist system. Mongolia developed its accounting systems in parallel with the Soviet Union throughout the 1920s and 1930s. The ‘Soviet accounting system’ catered to the needs of central planning, in particular, the system provided statistical information, including financial information. It emphasized standardization and uniformity so that information could be compared across sectors and industries. Detailed instructions negated the need for professional judgment in the accounts-preparation process. Therefore, public accounting firms and an accountancy profession were never necessary. In fact, accountancy had a very poor reputation. One study of professions ranked accountancy at 91st place in terms of prestige on a list of 92 professional occupations in the Former Soviet Union.  

Mongolia’s rejection of communism in 1990 placed it in the same position as other Soviet bloc countries concerning accounting arrangements. However, the Soviet accounting system created a sound basis on which to build. First, the system used many concepts of modern accounting including accrual measurement and double entry bookkeeping. Second, large numbers of bookkeepers were trained in these concepts and were proficient in their application.

2. Issues and Responses since 1990

In the decade since the beginning of the transition, Mongolia has made reasonable progress in terms of developing an accounting infrastructure suitable to the needs of a market economy. The magnitude of these accomplishments is best viewed by examining the 1991 situation. First, bookkeepers numbered in the tens of thousands but there were no qualified Certified Public Accountants (CPAs) let alone a professional accounting body. Second, financial information on the performance and position of organizations was not publicly available. In any case, this information did not meet international standards nor did it cater

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to the needs of investors or lenders. Third, the users of financial information (e.g., investors and creditors) were unfamiliar with what they should demand from organizations. Fourth, financial information was not independently verified (audited) to international standards and could not be relied upon. Fifth, the entire legal framework was geared to central planning and specified exactly what information should be produced, how it should be produced, and to whom it should be provided. Finally, the regulatory entities that generally exist in market economies to oversee financial disclosure practices, such as securities exchange commissions, did not exist. Table 1 summarizes developments in accounting arrangements in Mongolia over the past decade.

Table 1: The Development of Mongolia’s Accounting Infrastructure

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>The Mongolian Professional Accounting Council (MPAC) is established under the Accounting Law 1993. It is responsible for creating a competent accountancy and auditing profession. MPAC administers the inaugural Certified Public Accountant (CPA) examinations. National Association of CPAs is established.</td>
</tr>
<tr>
<td>1996</td>
<td>The Mongolian Institute of Certified Public Accountants (MICPA) is established and absorbs the membership of the National Association of CPAs.</td>
</tr>
<tr>
<td>1997</td>
<td>The Auditing Law tightens up the process for granting CPA titles. It also recognizes the existence of MICPA and specifies audit requirements for business enterprises and State-owned enterprises. The new law requires the use of International Standards on Auditing.</td>
</tr>
<tr>
<td>2000</td>
<td>MICPA is admitted to membership of the Confederation of Asian and Pacific Accountants (CAPA). MICPA advises that only about 500 of Mongolia’s 30,000 organizations have fully implemented IAS. Moreover, public accounting firms are auditing only 80 percent of the 440 businesses listed on the Stock Exchange.</td>
</tr>
</tbody>
</table>
3. The ‘Mongolian Accounting System’

Governing Laws and Regulations
The Ministry of Finance and Economy (MOFE) administers the Accounting Law 1993 that regulates the maintenance of accounting records and the preparation of balance sheets by business entities and organizations in both the private and the public sectors. The Law makes the Minister for Finance and Economy responsible for providing professional and methodological direction to Mongolian accounting arrangements. The Accounting Law 1993 also sets out financial reporting requirements. These require that the Minister for Finance and Economy must approve standard accounting forms and methods for business entities and organizations.

Accounting Bases
The Accounting Law 1993 allows organizations to maintain their records based on either single entry or double-entry bookkeeping. Article 3.3 requires that these must be consistent with International Accounting Standards (IAS).

Asset Management and Internal-Control Systems
The Accounting Law 1993, together with MOFE regulations, specifies criteria for asset management and internal-control practices. Organizations must record assets in standard registers; in general, these registers do not include details of location, purchase date or asset class and, in many cases, fixed assets are mixed with consumables, inventories, and tools. There is no capitalization cut-off point (some assets have values as low as T8 (i.e., less than one US cent).

Accounting Information Systems
With the exception of a few locally developed computerized accounting information systems, and a few foreign-developed computerized accounting information systems, private sector accounting systems are predominantly manual.
4. Financial Reporting Requirements

The Accounting Law 1993 requires that financial reporting must conform to International Accounting Standards (IAS). However, the reporting guidance that is issued by MOFE in many ways reflects taxation considerations. Although this guidance is generally in accordance with IAS, it creates confusion about the purpose of financial information.

Financial statements are required to 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).

With the exception of externally enforced reporting requirements for government executing agencies (chapter VI refers), benchmarks, covenants and ratios are not mandated for reporting purposes.

Part Two. Auditing

5. Introduction

Auditing in the Soviet Bloc, including Mongolia, reflected the highly prescriptive nature of the underlying accounting system. It was primarily a verification exercise, with the final accounts being compared to the bookkeeping records by accountants from another enterprise within the same group. It is not surprising that a fully functioning and competent audit profession has not been created within the short time frame of 10 years. For instance, as Table 1 related, of the 440 businesses listed on the Stock Exchange, licensed accounting firms are auditing only 80 percent.

6. Governing Laws and Regulations

The MOFE drafted the Auditing Law 1997 with assistance from Arthur Andersen. The Auditing Law 1997 is administered by the MOFE and MPAC and applies to the determination of auditing principles, administration of the process for registering auditing companies, and the process for

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12 ADB TA No. 2390-MON: Improving Accounting and Auditing Systems, for $600,000 approved in September 1995.
granting CPA qualifications. The CPA qualification-process is described in chapter III.

7. Audit Requirements

Article 7 of the Auditing Law 1997 requires that the following entities be subject to an annual independent audit:

- Banks
- Insurance companies
- Any other financial institutions
- Listed companies
- Companies intended to list
- Joint-venture enterprises
- fully- and partially-owned State enterprises, and
- Companies with capital of at least T30 million ($30,000).

8. Auditor Qualifications

The Auditing Law 1997 requires that licensed audit companies must conduct audits. The Minister of Finance and Economy is responsible for approving applications for licenses and relies on the recommendation of the MPAC. Qualified CPAs must staff audit companies.

9. The State Audit Board (SAB)

As its name implies, the State Audit Board (SAB) is responsible for conducting public sector auditing. The SAB is Mongolia's Supreme Audit Institution (SAI) and was established in 1995. In July 1996, the SAB joined the Asian Association of Supreme Audit Institutions (ASOSAI). The State Audit Law governs the operations and responsibilities of the SAB.

The principal functions of the SAB include monitoring and evaluating: budget allocations, government expenditure, the preservation and storage of government property, the expenditure of international aid and loans, and the ethical behavior of high-ranking public officers.

The Chairman of the State Audit Board (the Auditor-General), and its eight other senior members, are appointed by, and report directly to Parliament. Under the State Audit Law, the SAB is required to audit
Ministries, Agencies, capital city and Aimag (provinces), Sums (districts), authorized administrative bodies and local self-governing bodies.

The State Audit Board has 27 central staff. In addition, 22 Auditing Committees operate in each Aimag (province) and Ulaanbaatar with 150 staff. Of the 27 current staff in the center, no more than 18 are auditors/inspectors, operating in two divisions, while the other nine form the secretariat of the Board. Few of these staff have professional accounting qualifications or experience; rather they have been trained under the previous socialist regime to provide inspection or review services on government processes to ensure compliance with regulations.

10. Public Sector Auditing Issues

A review of public sector accounting arrangements, from an audit perspective, identified several potential issues as follows:\(^{13}\)

- Budget organizations do not manage their own financial management information systems that are capable of providing the necessary information to produce financial statements. They will either need to develop their own capabilities or else continue to rely on sources of information that they do not control.

- Large portions of the transactions carried out in Mongolia (e.g. payroll) are cash-based rather than being made through the banking system and electronic means. While audit trails can be devised to provide audit assurance over cash-based systems, they are much more cumbersome and prone to error than electronic-based transaction systems. For example, auditors usually use bank transaction tapes and statements as a key part of their evidence for transaction flows. These reports are externally sourced, have a high degree of reliability and are comprehensive. Such evidence is less easy to obtain and is less compelling when most transactions are cash rather than electronic transfers or checks.

11. Supervision of Bank Audits

Mongolia’s banking sector has been the source of significant economic and political problems over the past decade. Governments have collapsed over the issue of banking reform and the outcome has been a financial system dominated by rotten state banks and a welter of poorly supervised private ones. A recent political consensus has emerged that should enable the state to get out of banking, bring foreigners in, and improve supervision. In early 2000, the Bank of Mongolia forced the two worst performing State-owned banks - the Investment and Technological Innovation Bank, and the Reconstruction Bank - into liquidation. The latter possibly had the world’s highest bad-loan ratio of over 95 percent.\(^4\)

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 Standards or on Reporting by Financial Institutions.\(^5\)

12. Public Accounting and Auditing Firms

Mongolia has 41 registered public accounting firms of which Arthur Andersen is the only representative of the large international accounting firms. Auditing licenses are issued by MPAC as described in chapter III.

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\(^5\) ADB TA No. 2964-MON: Improving Accounting and Auditing Systems II. For $688,000 approved December 1997.
III. Professional Infrastructure

This chapter describes the professional accountancy infrastructure in Mongolia, which comprises the Mongolian Institute of Certified Public Accountants (MICPA) and its members. The chapter is structured as follows:

1. Introduction
2. The Certified Public Accountant (CPA) Title – describes the development and the current status of the CPA title.
3. Mongolian Institute of Certified Public Accountants – describes the legal framework, membership, and activities of MICPA.
4. Mongolian Professional Accounting Council (MPAC) – describes the legal status and operations of MPAC.
6. Initiatives to Strengthen the Profession – discusses initiatives to strengthen the profession.

1. Introduction

Because of Mongolia's state of development before 1922, and the ensuing seven decades of communism and central planning, Mongolia had no accountancy profession before 1992. In 1993, the National Association of CPAs was established and became MICPA in March 1996. MICPA was admitted to membership of the Confederation of Asian and Pacific Accountants (CAPA) in April 2000 and sees this as a step towards membership of the International Federation of Accountants (IFAC).

Three bodies are involved in the regulation and organization of Mongolia's accountancy profession: MICPA, MPAC, and the Accounting Division of MOFE. Table 2 describes respective organizational roles and responsibilities.
## Table 2: Organizational Roles and Responsibilities

<table>
<thead>
<tr>
<th>Roles and Functions</th>
<th>MICPA</th>
<th>MOFE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Membership</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Membership-based organization</td>
<td>✓</td>
<td>..</td>
</tr>
<tr>
<td>CPA Examination</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Curriculum determination</td>
<td>Advises ✓</td>
<td>..</td>
</tr>
<tr>
<td>• Examination preparation</td>
<td>Advises ✓</td>
<td>..</td>
</tr>
<tr>
<td>• Examination administration</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>• Examination grading</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>CPA Candidate Preparation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Training courses</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>CPA Titles</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Grants CPA titles</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>• Records CPA titles</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>Auditing Firm Licenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Receives and processes applications</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>• Recommends to Minister for Finance and Economy</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>• Maintains database of CPA firms</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>CPA Professional Ethics</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Drafts standards</td>
<td>✓</td>
<td>..</td>
</tr>
<tr>
<td>• Controls professional ethics</td>
<td>..</td>
<td>✓</td>
</tr>
<tr>
<td>Continuing Professional Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Conducts training</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

### 2. The Certified Public Accountant (CPA) Title

The Accounting Law 1993 established MPAC, whose chairperson reports directly to the Minister for Finance and Economy. The Law gave MPAC the authority to administer the professional accounting examinations that qualify accountants as CPAs. The inaugural CPA examinations were administered by MPAC in accordance with the Accounting Law 1993 in July 1993, but these examinations were prepared and graded by non-
CPAs. The syllabus, on which candidates were examined, did not include auditing.

The Auditing Law 1997 tightened up the process for granting CPA titles and requires that accountants pass a three-stage examination (Table 3 refers). CPAs do not have to meet continuing professional education requirements to retain the title.

<table>
<thead>
<tr>
<th>CPA Examination Status of CPA Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage I Candidates must have a degree in accounting. The CPA title is granted once a candidate passes this first examination – they are then permitted to conduct audits. The CPA title remains valid for two years by which time candidate must have passed second stage examination.</td>
</tr>
<tr>
<td>Stage II CPA title is valid for another five years by which time candidate must have passed the third stage examination.</td>
</tr>
<tr>
<td>Stage III Once the third examination is passed, and candidates can demonstrate ‘suitable’ practical experience, the CPA title is valid for life.</td>
</tr>
</tbody>
</table>

3. Mongolian Institute of Certified Public Accountants

Legal Framework

While the Accounting Law 1993 and the Auditing Law 1997 implicitly recognize the existence of MICPA, it has no explicit legal right to charge membership fees, nor does it have a legal right to issue accounting or auditing standards, or grant CPA titles.

Membership and Activities

MICPA had 366 members as at 31 December 1999. Females and males are represented equally; 116 members worked in the public sector (Central Government, local government and State enterprises), the other 250 worked in the private sector. Excluding honorary memberships (of which there are two), MICPA has only one membership category – that of CPA. MICPA works closely with MPAC and the Accounting Division
of the MOFE (it shares offices with MPAC). Links have been established through CAPA with the Korean and Japanese accounting professions but these relationships have yet to provide direct benefits.

MICPA has an active education campaign, including a media campaign, to improve public awareness of accountancy issues. The Institute publishes the fortnightly *Financial News* and the Quarterly Journal on Accounting and Auditing. These publications keep members and businesses updated on current professional issues. As membership fee payments are voluntary, 96 percent of the MICPA’s revenues are derived from commercial activities (Table 4 refers).

**Table 4: MICPA Revenues for the year ended 31 December 1999**

<table>
<thead>
<tr>
<th>Revenue Type</th>
<th>T 000s</th>
<th>US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Membership fees</td>
<td>1,545</td>
<td>1,545</td>
</tr>
<tr>
<td>Training activities</td>
<td>31,354</td>
<td>31,354</td>
</tr>
<tr>
<td>Other income (primarily from sales of textbooks and manuals)</td>
<td>3,057</td>
<td>3,057</td>
</tr>
<tr>
<td></td>
<td>35,956</td>
<td>35,956</td>
</tr>
</tbody>
</table>

Structure and Committees

Members elect the President of MICPA once every four to five years. In addition to the President, the Institute has four professional staff and 11 part-time support staff. The Institute carries out its activities under a four-committee system:

I. Ethics Committee
II. Training Committee
III. Accountancy Committee, and
IV. Audit Committee.

The role of the Ethics Committee is to: (i) administer and update the CPA code of professional ethics; (ii) supervise the observation of the CPA Code of Ethics; (iii) maintain the registry of CPAs and audit firms; (iv) preside over, and make conclusions on, breaches of ethics by CPAs and audit firms; (v) respond to member’s submissions on ethical breaches; (vi) provide regional chapters with appropriate management; and (vii) consider membership fee issues. MICPA’s Code of Ethics was

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FINANCIAL MANAGEMENT AND GOVERNANCE ISSUES IN MONGOLIA

developed and approved in 1997 with ADB support. The Code of Ethics has provisions relating to penalties, membership suspension and membership cancellation. Three members have been disciplined in the past five years.

The role of the Training Committee is to: (i) review the training curriculum and syllabus of universities, institutions, and colleges that provide accounting training, and to make recommendations to relevant bodies; (ii) develop programs and schedules for training seminars aimed at preparing accountants for the CPA examination; (iii) keep CPAs updated on current professional issues; (iv) develop CPA examination procedures and submit proposals to the MOFE and MPAC for consideration; (v) assist accountants preparing for the CPA examination by providing manuals and other materials; (vi) organize the writing, translating, and publishing of single-theme works and textbooks on accountancy; and (vii) plan the publication of Institute's periodicals and provide editorial guidance.

The role of the Accountancy Committee is to: (i) prepare proposals on the development and improvement of accounting standards and submit these to MOFE and MPAC for consideration; (ii) introduce accounting standards to business entities in conjunction with related bodies; (iii) develop instructions, manuals, other materials on financial, cost and managerial accounting and management advisory services, and to submit these to MOFE and MPAC for approval and distribute these to the general public; (iv) coordinate with MOFE and MPAC in respect of improving standards and instructions on financial statements for both government and nongovernmental organizations; (v) manage the preparation, translation, and publication of textbooks and manuals on financial, cost and managerial accounting, accounting information systems, and financial management; and (vi) prepare other information for members.

The role of the Audit Committee is to: (i) develop audit engagement standards and submit these to MOFE and MPAC for consideration and approval; (ii) supervise the audit engagement activities of audit firms; (iii) oversee the charges of audit firms; (iv) communicate with Securities Commission, the Stock Exchange and broker firms; (v) investigate disputes arising from audit engagements

17 TA No. 2390-MON: Strengthening the Accounting and Auditing Profession, for $600,000, approved in September 1995.
and submit comments on these disputes to MOFE and MPAC for consideration; (vi) organize seminars on methodological issues for audit firms; (vii) produce manuals and other required materials on internal-control issues; (viii) organize tax advisory services for organizations and individuals and encourage the development of these services; and (ix) inform members of legislative changes.

4. Mongolian Professional Accounting Council (MPAC)

MPAC was established by the Accounting Law 1993 to regulate the accounting profession, license accounting firms and improve the accountancy profession. Chapter 31 of the Auditing Law 1997 states that there is to be a permanent chairperson and six members. The Chairperson and members are appointed for up to five years. The Council’s functions are to: (i) recommend standards for accounting and auditing; (ii) review the CPA curricula; (iii) prepare CPAs for their exams; (iv) prepare CPA exams; (v) conduct CPA exams; (vi) grant CPA titles; (vii) record CPA titles; (viii) process and review auditing licenses and make recommendations to the Minister; (ix) maintain a database on auditing companies; and (x) control professional ethics.

5. Continuing Professional Education (CPE)

CPE is provided by both MICPA and MPAC. There is no set program, nor are there set requirements for CPAs. However, MICPA is in the process of developing a program for CPE.

6. Initiatives to Strengthen the Profession

ADB has provided two Technical Assistance grants to establish and to strengthen Mongolia's accountancy profession. Chapter VII provides detailed information on these grants. In summary:

- **TA No. 2390-MON:** Improving Accounting and Auditing Systems\(^{18}\), assisted MICPA to develop Articles of Association, By-laws, and a Code of Professional Ethics.
- **TA No. 2964-MON:** Improving Accounting and Auditing Systems II\(^ {19}\) activities included:

\(^{18}\) For $600,000, approved in September 1995.
\(^{19}\) For $688,000, approved in December 1997.
• preparing 34 accountants for international standard CPA examinations and conducting these examinations; 18 candidates passed the examinations. As at 31 October 2000, MPAC had yet to grant the CPA title to the 18 successful candidates.

• Assisting MICPA. Supporting activities involved developing policies, rules, and regulations on the preparation, administration, and grading of CPA examinations; and a study tour for accounting personnel to examine Asian professional organizations. These TAs also included other significant components such as the development of accounting and auditing laws, training, and textbook procurement and translation.
IV. Accounting and Auditing Standards

This chapter describes the accounting and auditing standards that govern the preparation of external financial reports and the audit of those reports. The chapter comprises seven sections, in two parts, as follows:

Part One: Accounting Standards
1. Accounting Standard Setting Responsibilities – describes the roles and responsibilities of organizations involved in the accounting standard setting process.
4. Conformity with International Accounting Standards – analyses differences between Mongolian accounting standards and IAS.

Part Two: Auditing Standards:
6. Legal Basis – describes the legal basis for Mongolian auditing standards.

Part One. Accounting Standards

1. Accounting Standard Setting Responsibilities

Three organizations contribute to the development of private sector accounting standards: the Accounting Division of the Ministry of Finance and Economy (MOFE), the Mongolian Professional Accounting Council (MPAC), and the Mongolian Institute of Certified Public Accountants (MICPA). The respective responsibilities of these organizations are as follows:

• MICPA is not legally involved in the standard-setting process but has established the Accounting Committee which prepares proposals on the development and improvement of accounting standards, and disseminates information on accounting standards to business entities (chapter III refers).
• Under the Auditing Law 1997, MPAC is responsible for suggesting improvements to accounting standards and submitting these to MOFE for consideration. However, MPAC is not particularly active in this respect.

• Under the Accounting Law 1993, the Accounting Division of MOFE is also responsible for developing accounting standards. It promulgates these by way of regulation. In March 2000, the Fiscal Policy Division of MOFE assumed responsibility for setting public sector accounting standards.

2. Accounting Standard Setting Process

As mentioned above, three organizations are involved in developing and promulgating accounting standards. There is however, no formalized process for development, exposure, approval, and promulgation. Rather, drafts are circulated around selected organizations for comments.

3. Mongolian Accounting Standards

Mongolian accounting standards are part of a ‘uniform accounting system’ based on the former Soviet accounting system. In this respect, detailed accounting instructions and reporting formats are issued, of which accounting standards are an integral part. The accounting instructions also include taxation requirements.

4. Conformity with International Accounting Standards

Private sector accounting standards must conform to International Accounting Standards (IAS):

“Accounting forms and methods [must] be consistent with International Accounting Standards.”

Accounting Law 1993 (Article 4.3.3.).

Table 5 examines differences between the ‘Mongolian Accounting System’ and IAS. The identified differences are due to either treatments not being specified (e.g. IAS 9) or accounting choices being restricted (e.g., IAS 4 – straight-line depreciation must be used).
<table>
<thead>
<tr>
<th>International Accounting Standards (IAS)</th>
<th>Comparison Against the Mongolian Accounting System</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IAS 1</strong> Presentation of Financial Statements</td>
<td>• The accounts preparation process - including preparation of source documents, journal preparation and posting, ledger account maintenance and preparation of final statements - is specified in detail. Given this level of prescription, underlying assumptions for the preparation of financial statements are not included (with the exception of the ‘going concern’ assumption).&lt;br&gt;• Comparative financial information must be prepared, however there is no specific requirement to disclose this information.</td>
</tr>
<tr>
<td><strong>IAS 2</strong> Inventories</td>
<td>The weighted-average cost method is mandated.</td>
</tr>
<tr>
<td><strong>IAS 4</strong> Depreciation</td>
<td>The straight-line depreciation method is mandated.</td>
</tr>
<tr>
<td><strong>IAS 8</strong> Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies</td>
<td>• The definition / treatment of the following items is not specified:&lt;br&gt;  • Abnormal / exceptional items&lt;br&gt;  • Correction of fundamental accounting errors&lt;br&gt;  • Changes in accounting policies&lt;br&gt;  • Changes in accounting estimates, and&lt;br&gt;  • Discontinued operations.</td>
</tr>
<tr>
<td><strong>IAS 9</strong> Research and Development Costs</td>
<td>Not specified.</td>
</tr>
<tr>
<td><strong>IAS 10</strong> Contingencies and Events Occurring After Balance Date</td>
<td>Same as IAS.</td>
</tr>
<tr>
<td><strong>IAS 11</strong> Construction Contracts</td>
<td>With the exception of the requirement to disclose current period contract revenue and contract completion stage, requirements are not specified.</td>
</tr>
</tbody>
</table>
## Accounting and Auditing Standards

<table>
<thead>
<tr>
<th>International Accounting Standards (IAS)</th>
<th>Comparison Against the Mongolian Accounting System</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IAS 12</strong> Income Taxes</td>
<td>Deferred tax liabilities and tax assets should only be recognized for temporary and permanent differences in respect of depreciation.</td>
</tr>
<tr>
<td><strong>IAS 14</strong> Segmental Reporting</td>
<td>Requirements are not specified.</td>
</tr>
<tr>
<td><strong>IAS 16</strong> Property, Plant and Equipment</td>
<td>Treatments are similar to IAS, however the treatment of changes in useful lives and depreciation methods is not specified.</td>
</tr>
</tbody>
</table>
| **IAS 17** Accounting for Leases         | • The treatment of financial leases is not specified.  
<pre><code>                                      | • The treatment of operating lease expenses is in accordance with IAS. |
</code></pre>
<p>| <strong>IAS 18</strong> Revenue                      | The measurement of revenue is the same as IAS except that there is no provision for exchange. |
| <strong>IAS 19</strong> Employee Benefits             | Not specified.                                   |
| <strong>IAS 21</strong> The Effects of Changes in Foreign Exchange Rates | Similar to IAS except that the Central Bank (Bank of Mongolia) rates must be used for conversion purposes. |
| <strong>IAS 22</strong> Business Combinations        | Same as IAS.                                    |
| <strong>IAS 23</strong> Borrowing Costs              | Same as IAS.                                    |
| <strong>IAS 24</strong> Related Party Disclosures     | Disclosures are specified but treatments are not. |
| <strong>IAS 25</strong> Accounting for Investments   | Same as IAS except that revaluation treatments on investment disposals are not specified. |
| <strong>IAS 26</strong> Accounting and Reporting by Retirement Benefit Plans | Not specified.                                   |</p>
<table>
<thead>
<tr>
<th>International Accounting Standards (IAS)</th>
<th>Comparison Against the Mongolian Accounting System</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 27 Consolidated Financial Statements and Accounting for Investments in Subsidiaries</td>
<td>Disclosure requirements are specified but treatments are not.</td>
</tr>
<tr>
<td>IAS 28 Accounting for Investments in Associates</td>
<td>Disclosure requirements are specified but treatments are not.</td>
</tr>
<tr>
<td>IAS 29 Financial Reporting in Hyper-Inflationary Economies</td>
<td>Not specified (Mongolia is not a hyper-inflationary economy within the definition of IAS 29).</td>
</tr>
<tr>
<td>IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions</td>
<td>These disclosure requirements are regulated by special rules issued by the Bank of Mongolia.</td>
</tr>
<tr>
<td>IAS 31 Financial Reporting of Interests in Joint Ventures</td>
<td>Disclosure requirements are specified but treatments are not.</td>
</tr>
<tr>
<td>IAS 32 Disclosure and Reporting of Financial Instruments</td>
<td>Not specified.</td>
</tr>
<tr>
<td>IAS 33 Earnings per Share</td>
<td>Similar to IAS.</td>
</tr>
<tr>
<td>IAS 34 Interim Financial Reporting</td>
<td>Not specified. However, the Accounting Law 1993 requires that quarterly financial statements must be prepared on the same basis as annual financial statements.</td>
</tr>
<tr>
<td>IAS 35 Discontinued Operations</td>
<td>Not specified.</td>
</tr>
<tr>
<td>IAS 36 Impairment of Assets</td>
<td>Not specified.</td>
</tr>
</tbody>
</table>
ACCOUNTING AND AUDITING STANDARDS

<table>
<thead>
<tr>
<th>International Accounting Standards (IAS)</th>
<th>Comparison Against the Mongolian Accounting System</th>
</tr>
</thead>
</table>
| **IAS 37** Provisions, Contingent Liabilities and Contingent Assets | • Contingent liabilities must be disclosed in the notes to the financial statements.  
• There are no requirements in relation to contingent assets. |
| **IAS 38** Intangible Assets | • Definition is similar to IAS.  
• Must be valued at historical cost and amortized on a straight-line basis over 1 to 40 years.  
• Tax law requires that amortization be on a straight-line basis over 10 years. |

5. Public Sector Accounting Standards

The Fiscal Policy Department of the MOFE has recently assumed responsibility for developing and promulgating accounting standards for public sector reporting. Public sector organizations currently report based on a ‘uniform accounting system’ of the Soviet accounting system. In this respect, detailed accounting instructions and reporting formats are issued, of which accounting standards are an integral part.

In 1998, as part of the Public Administration Reform Project (PARP), accounting policies were developed based on IAS and (the then unreleased) International Public Sector Accounting Standards (IPSAS). Guidance and instructions are incorporated in three documents: (i) the Framework for Financial Reporting in the Public Sector sets out and explains the concepts and principles that underlie IAS in terms of their application to Mongolian public sector reporting; (ii) the Accounting Policies contains the accounting policies for public sector reporting; and (iii) the Reporting Formats for public sector reporting (forecast financial statements and actual accounting statements) provide a set of pro-forma statements for individual organizations and for the Government as a whole.

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20 ADB TA No. 2931-MON: Program Preparation for Governance Reforms, for $967,000 approved in December 1997.
Annual financial statements for the five pilot agencies involved in the first implementation stage of the Public Administration Reform Project have been prepared based on these instructions and guidance.

Part Two. Auditing Standards

6. Legal Basis

The Auditing Law 1997 requires that auditors apply International Standards on Auditing (ISA). Consequently, Mongolian auditing standards are a direct translation of ISA.

7. Development and Promulgation

As with accounting standards, three organizations contribute to the promulgation of auditing standards; the Accounting Division of MOFE, MPAC, and MICPA. The responsibilities of these organizations are as follows:

- **MICPA** is not legally involved in the standard-setting process but has established the Accounting Committee which prepares proposals on the development and improvement of auditing standards, and disseminates information on auditing standards to audit firms (chapter III refers).

- Under the Auditing Law 1997, **MPAC** is responsible for proposing improvements to auditing standards and submitting these to the Ministry of Finance and Economy for consideration. However, MPAC is not particularly active in this respect.

- Under the Accounting Law 1993, the **Accounting Division** of the MOFE is also responsible for developing auditing standards. It promulgates these by way of regulation.

As mentioned above, three organizations are involved in developing and promulgating auditing standards. There is however, no formalized process for development, exposure, approval, and promulgation.
V. Accounting and Auditing Training

This chapter describes accounting and auditing education and training. It is structured as follows:

1 - Introduction
2 - Educational Coordination - describes the coordination of accountancy education within Mongolia.
3 - Tertiary Education - describes the providers of tertiary accountancy education and the training of accounting lecturers and professors.
4 - Other Training Institutions - describes the training activities of the Mongolian Professional Accounting Council (MPAC) and the Accounting Division of the Ministry of Finance and Economy (MOFE).
5 - Donor-Supported Training Activities - reviews the various training activities that have been, or are being, supported by donor agencies.

1. Introduction

Most accounting and auditing skills are generally considered to be developed through on-the-job practical training and work experience. That aside, educational standards, particularly at the undergraduate level determine the basic level of knowledge that new entrants to the accounting market have. The higher this level is, the faster that skill will be developed.

Communism has left Mongolia with a legacy of high educational standards - particularly in the sciences - on which to build. Like many other countries in transition, Mongolia has a very large number of ‘accountants’. The MOFE estimates that there are 4,000 to 5,000 public sector ‘accountants’ and around a further 30,000 private sector

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Acknowledgement: The material presented in this chapter, and the associated recommendations presented in chapter VIII, draws heavily on the following recent UNDP-sponsored reports:

‘accountants’. In reality, most of these accountants are bookkeepers and producers of statistical information.

2. Educational Coordination

MPAC, together with the Ministry of Education, Culture and Science, conducts biannual reviews of the accounting courses offered by tertiary training institutions. These reviews are cursory in nature and mainly relate to the issuance of licenses to conduct training. The Accounting Law 1997 states that organizations may conduct accountancy training only with the permission of Ministry of Education, Culture and Science and MOFE. In addition, MICPA provides input to the development of the accounting and auditing curricula of the tertiary institutions and MPAC. Earlier this year, a Training Task Force was established within MOFE to coordinate public sector accountancy training activities.

3. Tertiary Education

Mongolia has moved away from the Soviet educational model in the past 10 years. Before 1991, accountancy was not taught as a major in universities and colleges. Five State institutions now offer undergraduate and postgraduate programs in accountancy (Table 6 refers) but, as these institutions are unable to meet demand, a number of private sector accountancy training providers have emerged. There are about 30 private sector training organizations of which only one, Mandakh, specializes in accounting and finance training.

Table 6: State Tertiary Institutions

<table>
<thead>
<tr>
<th>Institution</th>
<th>Courses of Study</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institute of Finance and Economics:</td>
<td>Diploma in Accounting (3½ years fulltime)</td>
<td>BA program:</td>
</tr>
<tr>
<td>Department of Accounting</td>
<td>BA in Accounting (4 years fulltime, 4 years+ part-time)</td>
<td>• 200 students (1,000 applicants).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Faculty strength:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 16 (of whom four are professionally qualified).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Institution</th>
<th>Courses of Study</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mongolian State University:</td>
<td>BA in Accounting (4 years fulltime)</td>
<td>BA program:</td>
</tr>
<tr>
<td>• Faculty of Finance and Accounting</td>
<td>MA in Accounting (12–18 months)</td>
<td>• 80 students (1,000 applicants).</td>
</tr>
<tr>
<td></td>
<td>Ph.D. program, beginning in 2000.</td>
<td>Faculty strength:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 15 (of whom two are professionally qualified).</td>
</tr>
<tr>
<td>Institute of Agriculture:</td>
<td>BA in Accounting (4 years fulltime, 5 years part-time)</td>
<td>BA program:</td>
</tr>
<tr>
<td>• Accounting Department</td>
<td></td>
<td>• 120 students (1,000 applicants).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Faculty strength:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 14 (of whom two are professionally qualified).</td>
</tr>
<tr>
<td>Institute of Commerce and Business:</td>
<td>Diploma in Accounting (3 years fulltime)</td>
<td>BA program:</td>
</tr>
<tr>
<td>• Department of Accounting and Analysis</td>
<td>BA in Accounting (4 years fulltime)</td>
<td>• 60 students (300 applicants).</td>
</tr>
<tr>
<td></td>
<td>MA in Accounting (18 months)</td>
<td>Faculty strength:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 14 (of whom four are professionally qualified).</td>
</tr>
<tr>
<td>Academy of Management:</td>
<td>Diploma in Public Administration (1 year fulltime, 2 years part-time)</td>
<td>DPA – 270 students</td>
</tr>
<tr>
<td>• Faculty of Economics</td>
<td>Diploma in Business Administration (1 year fulltime, 2 years part-time)</td>
<td>DBA – 80 students</td>
</tr>
<tr>
<td></td>
<td>Master of Public Administration (1 year fulltime, 2 years part-time)</td>
<td>MPA – 10 students</td>
</tr>
<tr>
<td></td>
<td>Master of Business Administration (1 year fulltime, 2 years part-time)</td>
<td>MBA – 16 students</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Faculty strength:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 70 (of whom four are professionally qualified).</td>
</tr>
</tbody>
</table>
ADB is supporting the Government’s efforts to reform the education sector, as a whole, through the Education Sector Development Program. The objective of the Education Sector Development Program is to make the sector more effective, responsive, and sustainable. ADB has provided substantial assistance in this respect. The Government is in the process of preparing an updated Education Sector Strategy (2001-2005). It is expected that emphasis will be placed on basic and non-formal/distance education, market-driven vocational education and the strengthening of science and technology at the tertiary level.

The recent UNDP report identified several issues with respect to tertiary training:

- Teaching aids – the blackboard is the prime teaching tool due to budgetary constraints.
- Textbooks – there is a shortage of Mongolian textbooks, in terms of both quantity and range. Moreover, the quality of these texts is poor in terms of translation and their application to the Mongolian environment.
- Staff development – the faculty members that were interviewed as part of the UNDP study acknowledged that their accounting knowledge and skills base could be improved, but the opportunities for further studies were limited due to financial constraints.
- Teaching methods – these tend to focus on the traditional lecture approach. To an extent, this is due to accounting lecturers being paid based on hours taught. Not only does this compromise learning effectiveness but also lecture hours are very high at the expense of tutorials and research.
- Academic association – accountancy lecturers do not have an association.

See, for instance: Loan 1507-M ON: Education Sector Development Program, for $6.5 million approved on 19 December 1996; Loan 1508-M ON: Education Sector Development Project, for $9.0 million approved on 19 December 1996; TA No. 2719-M ON: Institutional Strengthening in the Education Sector, for 950,000 approved on 19 December 1996; TA No. 3174-M ON: Education Sector Strategy Study 2000-05, for $150,000 approved on 12 March 1999.

PPTA No. 3351-M ON: Second Education Development Program, for $550,000 approved on 20 December 1999.

• Training for academics - accountancy lecturers do not receive targeted training.

4. Other Training Institutions

Mongolian Professional Accounting Council (MPAC)

In addition to its coordination activities, MPAC conducts training for CPA examination candidates. It also promotes continuing professional education (CPE). To this end, each Aimag (province) has an accounting specialist, appointed by the Aimag administration, who is responsible for making training requests to MPAC.

Ministry of Finance and Economy

The MOFE is an active trainer. The Fiscal Policy Department conducts workshops for budget specialists relating to the application of new budget preparation guidelines and changes to the budget timetable. The Accounting Division conducts training on newly issued accounting regulations. It also provides training resources under the auspices of MPAC and MICPA.

5. Donor-Supported Training Activities

Donor-supported accountancy training activities include the following.

ADB: Improving Accounting and Auditing Systems

This TA was conducted from March 1996 to May 1997. Training-related activities included: the preparation of a training manual for accountants (117 pages), the preparation of an auditing manual for Mongolia (143 pages), the development and delivery of a training program (three seminars) on: financial accounting, managerial accounting, and accounts conversion. The seminars were based around a case study. Additional courses on accounting information systems and auditing were also developed and delivered.

26 TA No. 2390-MON: Improving Accounting and Auditing Systems, for $600,000 approved in September 1995.
ACCOUNTING AND AUDITING TRAINING

ADB: Improving Accounting and Auditing Systems II
This TA was conducted from March 1998 to March 2000. TA activities included: preparing 45 accountants for international standard CPA examinations and conducting these examinations (18 candidates passed the examinations but have not received their qualifications from MOFE).

World Bank Fiscal TA
The Fiscal TA has supported, and will continue to support, accountancy training in the public sector and training in the computerized accounting information systems that will be procured with the Fiscal TA funds.

Australia (AusAID)
Australia is providing support to the State Audit Board in association with the ADB-supported governance reform program. The support involves provision of auditors from the Victorian Auditor-General’s Office to the State Audit Board. The Australian auditors are working alongside the SAB auditors to review the financial statements that have been prepared for the five pilot agencies.

Japan (JICA)
Japan is supporting the design and implementation of a Public Investment plan (PIP) Budgeting Process in the Ministry of Finance and Economy through the provision of consulting advice and training (September 1998 to March 2001).

Germany (GTZ)
Germany is providing support to the State Audit Board through a project titled Institutional Strengthening of the State Audit Board (SAB) [DM 3 million; April 1998 – March 2001]. The project aims to improve state auditing (methodologies and technical skills) by providing equipment, training and short-term experts. The project involves training (seminars and study tours) staff from the SAB, MOFE and Academy of Management (AOM).

27 TA No. 2964-M ON: Improving Accounting and Auditing Systems II, for $688,000 approved in December 1997.
EU-TACIS: Academy of Management (AOM)
The AOM is the Government’s prime management training provider. EU-TACIS is supporting a major initiative to strengthen the AOM’s training capacity. The aim of this project is to improve the effectiveness and efficiency of public administration through provision of short- and long-term training of public administrators. The curriculum includes modules on public sector financial management.  

UNDP: International Accounting Standards Training
The UNDP has sponsored the development of a six-module training program on International Accounting Standards, financial accounting, management accounting, costing, auditing, and public sector management. Tenders for delivery of the training were called in 1999 and several training institutions were contracted to deliver the training to around 1,600 public sector accountants. This approach was adopted for three reasons. First, the cost of training being delivered by local institutions was much lower than would have been the case for international consultants. Second, language barriers were minimized. Third, the approach strengthened training institutions along with trainees. Preliminary anecdotal feedback indicates that the program has been extremely effective.

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28 Strengthening of the Academy of Management (AOM). ECU 0.800 million; May 1999–November 2000.
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


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.”

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.  

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” 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.


31 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:

<table>
<thead>
<tr>
<th>Primary Objectives</th>
<th>Secondary Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve Strategy Formulation, Strategic Resource Allocation, and Transparency, at the Aggregate Level.</td>
<td>• Improve the process of government strategy formulation and resource allocation as reflected in the annual budget process</td>
</tr>
<tr>
<td></td>
<td>• Improve the transparency surrounding the development and execution of government strategic and fiscal policy</td>
</tr>
<tr>
<td></td>
<td>• 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.</td>
</tr>
<tr>
<td>Improve the Efficiency and Effectiveness of Service Delivery by Central Government</td>
<td>• Introduce mechanisms which reward good performance and punish poor performance</td>
</tr>
<tr>
<td></td>
<td>• Implement output-based budgeting in central government</td>
</tr>
<tr>
<td></td>
<td>• Implement accrual budgeting and reporting for central government</td>
</tr>
<tr>
<td></td>
<td>• Implement a performance monitoring regime for general managers in central government</td>
</tr>
</tbody>
</table>
### Primary Objectives


#### Secondary Objectives

- Improve banking and cash flow management
- Improve debt and investment management

Improve the Performance of the State Enterprise Sector

#### Secondary Objectives

- Improve the accountability and transparency of the State enterprise sector
- Improve the governance arrangements for state enterprises

Improve the Performance of the Local Government Sector

#### Secondary Objectives

- Improve the arrangements of inter-governmental relations

Improve Government Performance

#### Secondary Objectives

- Clarify Policy Development, Regulatory, Service Delivery, and Commercial Roles
- Encourage privatization

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:

<table>
<thead>
<tr>
<th>Organization / Area Description Supported by</th>
<th>Supported by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Administration Reform Project Team Training in reform concepts, design and implementation. Preparation of:</td>
<td>ADB TA. 2868</td>
</tr>
<tr>
<td>• accounting policies (that conform to International Accounting Standards and International Public Sector Accounting Standards), financial-reporting formats, and guidance materials</td>
<td>ADB TA. 2931</td>
</tr>
<tr>
<td>• employment guidelines</td>
<td></td>
</tr>
<tr>
<td>• formats and guidance materials on the preparation of strategic business plans</td>
<td></td>
</tr>
<tr>
<td>• cost accounting policies and associated guidance materials</td>
<td></td>
</tr>
<tr>
<td>Organization / Area</td>
<td>Description</td>
</tr>
<tr>
<td>---------------------</td>
<td>-------------</td>
</tr>
<tr>
<td>Ministry of Finance and Economy</td>
<td>Support on budget-process design, training in PIP budgeting and training in the requirements of the new system.</td>
</tr>
<tr>
<td>State Audit Board</td>
<td>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.</td>
</tr>
<tr>
<td>State Service Council</td>
<td>Training in the requirements of the new system (including remuneration setting and performance management).</td>
</tr>
<tr>
<td>Cabinet Secretariat</td>
<td>Training in the requirements of the new system.</td>
</tr>
<tr>
<td>Parliamentarians and Ministers</td>
<td>Study tours and seminars on the new system</td>
</tr>
<tr>
<td>Management (including financial, human resource and planning)</td>
<td>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.</td>
</tr>
</tbody>
</table>
In December 1999, ADB approved a $25 million program loan, along with three technical assistance, to support the governance reforms. 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
review of the financial statements of two pilot agencies for which financial statements had been prepared. The reviewers commented that:\textsuperscript{33}

“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

\textsuperscript{33} 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). 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 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.

35 ADB TA No. 3031-MON. Development of Procurement Legislation and Guidelines.
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.
VII. Donor Assistance

This chapter describes donor coordination mechanisms and discusses donor activities in relation to financial management and governance arrangements. It is structured as follows:

1. Overview
2. Coordination Mechanisms
3. Asian Development Bank
4. International Monetary Fund (IMF)
5. The World Bank
6. United Nations (UNDP)
7. Australia (AusAID)
8. Japan (JICA)
9. European Union (EU-TACIS)
10. Germany (GTZ)

1. Overview

Table 7: Overall External Assistance to Mongolia

<table>
<thead>
<tr>
<th>External Source (US$ million)</th>
<th>1994 – 1998 (Commitments)</th>
<th>1999 Program</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loan/ Credit TA</td>
<td>Loan/Credit TA</td>
</tr>
<tr>
<td>Multilateral</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ADB</td>
<td>274.7 29.4</td>
<td>76.0 8.0</td>
</tr>
<tr>
<td>IBRD</td>
<td>108.7 ..</td>
<td>52.0 ..</td>
</tr>
<tr>
<td>IMF</td>
<td>48.0 ..</td>
<td>17.0 ..</td>
</tr>
<tr>
<td>EU-TACIS</td>
<td>.. 14.3</td>
<td>.. 5.3</td>
</tr>
<tr>
<td>UNDP</td>
<td>.. 14.6</td>
<td>.. 4.3</td>
</tr>
<tr>
<td>UNFPA</td>
<td>.. ..</td>
<td>.. 2.5</td>
</tr>
<tr>
<td>IFAD</td>
<td>5.1 ..</td>
<td>.. ..</td>
</tr>
<tr>
<td>Bilateral</td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>.. 5.9</td>
<td>.. 0.1</td>
</tr>
<tr>
<td>Germany</td>
<td>45.1 9.5</td>
<td>.. 9.3</td>
</tr>
<tr>
<td>Japan</td>
<td>46.0 4.4</td>
<td>115.0 ..</td>
</tr>
<tr>
<td>South Korea</td>
<td>8.0 0.5</td>
<td>118 ..</td>
</tr>
<tr>
<td>United States</td>
<td>.. 66.8</td>
<td>.. 16.0</td>
</tr>
<tr>
<td>Others</td>
<td>.. ..</td>
<td>.. 3.4</td>
</tr>
</tbody>
</table>

Mongolia receives the highest per capita level of external assistance of the seven countries participating in RETA-5877 (Table 8 refers).

Table 8: Official Development Assistance

<table>
<thead>
<tr>
<th>Country</th>
<th>Dollars per capita</th>
<th>Percentage of GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>36</td>
<td>12.1</td>
</tr>
<tr>
<td>People's Republic of China</td>
<td>2</td>
<td>0.2</td>
</tr>
<tr>
<td>Mongolia</td>
<td>99</td>
<td>26.7</td>
</tr>
<tr>
<td>Pakistan</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>78</td>
<td>7.8</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>6</td>
<td>0.5</td>
</tr>
<tr>
<td>Vietnam</td>
<td>13</td>
<td>4.1</td>
</tr>
</tbody>
</table>

2. Coordination Mechanisms

ADB has taken a lead coordination role in several key sectors including education, health, finance, roads, telecommunications, power, air navigation, and housing. Among its activities, ADB has financed the preparation of several sectoral master plans that provide frameworks within which to coordinate projects proposed for external assistance. The UNDP is active in local donor coordination and sponsors a monthly meeting of representatives from the Government and the donor community. The development of the Public Investment Program (PIP) will further assist in donor coordination and aid-prioritization efforts.

3. Asian Development Bank

Since Mongolia joined ADB in 1991, ADB operations have grown steadily in terms of volume and the number of sectors covered. ADB is the second largest donor after Japan. By December 1999, ADB had approved 21 loans, amounting to $427.5 million. Lending operations were dominated by program loans (32 percent). At the same time, ADB had approved 89 technical assistance (TA) grants totaling $45.3 million.

Despite economic uncertainty, fiscal constraints, and institutional weaknesses in all sectors, ADB's portfolio is in general performing satisfactorily and implementation is proceeding on schedule. As of 31

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38 Financed by ADB TA. No. 3317-MON: Public Expenditure Management. $496,000, approved in December 1999.
December 1999, audited accounts were due for 10 loans of which nine had complied and one had not yet complied.40

Loan Projects
Three program loans are directly related to supporting improved financial management and governance arrangements. First, the Financial Sector Program Loan I41 supported strengthening of the banking system, including the legal and regulatory framework. Second, the Financial Sector Program Loan II42 is intended to further strengthen governance arrangements in the sector – including further attention to legal and regulatory deficiencies. Finally, the Governance Reform Program Loan is intended to support the Government’s intention to pilot administrative reforms, including the adoption of IAS-based accounting, in five government agencies.43

In addition to these loans, technical assistance is often provided alongside loans to strengthen financial management within executing agencies.44

Technical Assistance
Along with the assistance provided to executing agencies to strengthen their financial management capacity, assistance has been provided to coordinating agencies to improve their loan administration and accounting procedures (in relation to ADB projects).45 The major initiatives that ADB has supported, or is supporting, are as follows:

TA No. 2390-MON: Improving Accounting and Auditing Systems
This TA for $600,000 was approved in September 1995 and was conducted from March 1996 to May 1997. TA activities included:

41 Loan 1509-MON: Financial Sector Program, for $35 million, approved on 16 December 1996.
42 Financial Sector Program II, for $15 million.
43 Loan 1713-MON: Governance Reform Program, for $25 million, approved on 2 December 1999.
44 See, for instance, TA. No. 2571-MON: CES Accounting and Financial Management Systems Improvement. $550,000, approved in May 1996.
45 See, for instance, TA No. 2993-MON: Capacity Building in Project Accounting, for $150,000, approved in March 1998.
preparation of a training manual for accountants (117 pages),
preparation of an auditing manual for Mongolia (143 pages),
development of a draft audit law, assistance to establish the critical
mass of a national accounting profession (articles of association, by-
laws, and code of ethics), and development and delivery of a training
program (three seminars) on financial accounting, managerial
accounting, and accounts conversion (all based around a case study).
Additional courses on accounting information systems and auditing
were also developed and delivered.

TA No. 2931-MON: Program Preparation for Governance Reforms
This TA for $967,000 was approved in December 1997 and was
conducted from April 1998 to September 1999. The technical assistance
provided under the contract had three aspects: assisting the
Government to prepare the inputs for a possible program loan on
governance reforms, assisting in the development, refinement and
communication of the draft legislation (the Public Sector Management
and Finance Law (PSMFL), and supporting the groundwork for the
implementation of the reforms arising from the enactment of the
PSMFL. With respect to the third aspect, this involved developing
accounting policies and accounting guidelines for the public sector
based upon IAS and International Public Sector Accounting Standards
(IPSASs). It also involved assisting five pilot agencies to prepare annual
financial statements based on these financial policies.

TA No. 2964-MON: Improving Accounting and Auditing Systems II
This TA for $688,000 was approved in December 1997 and conducted
from March 1998 to March 2000. TA activities included:
• preparing 34 accountants for international standard CPA
  examinations and conducting these examinations (18 candidates
  passed the examinations),
• providing 850 accountancy textbooks in Russian and Mongolian,
  and
• assisting MICPA. Supporting activities involved: (i) developing
  policies, rules, and regulations on the preparation, administration,
  and grading of CPA examinations; (ii) conducting a study tour for
  accounting personnel to examine Asian professional organizations;
  and (iii) developing accountants’ knowledge of, and familiarity
  with, the application of IAS and auditing practices, to banks and
  financial institutions.
TA No. 3316-MON: Initial Phase of Public Administration Reform
This TA for $700,000 was approved in December 1999. Its broad objectives are to move five pilot agencies to output-based budgeting. As part of this process, accrual-based financial reporting will be entrenched in the five organizations.

4. International Monetary Fund (IMF)
Mongolia joined the Fund in 1991 under Article VIII and is on the standard 12-month cycle for Article IV consultations. The Fund has provided three Technical Assistances on public expenditure management, which did not directly involve accounting or auditing.

5. The World Bank
Mongolia became a member of the World Bank, the International Development Agency, and International Finance Corporation in February 1991. The World Bank approved a Fiscal TA project of $5 million in June 1998, which was ratified by the Mongolian Parliament in January 1999. The intention of this project is to support the development of an efficient and transparent government financial management system, and the introduction of a value-added tax to strengthen the government’s revenue base. The Fiscal TA provides funding for: (i) computerized government financial management information systems (including debt, cash, treasury management, whole-of-government consolidation, and organizational accounting); (ii) training in management development; (iii) training in accrual accounting and budgeting; and (iv) developing attest auditing capacity.

An earlier project, the Accounting Development Project, was implemented from July 1993 to September 1994. The project involved: (i) converting the accounting systems of three State-owned enterprises (including the Trade & Development Bank) to IAS; (ii) developing a strategic plan for improving accounting and auditing system; (iii) updating the accounting curricula for universities; and (iv) providing training in financial and management accounting for accountants of major SOE and tertiary institutions.
6. **United Nations (UNDP)**

The UNDP is involved in financial governance issues through its Program for Accountability and Transparency (PACT). The Accounting Training Project [$76,000; 1999/2000] has involved the development and delivery of a training program to finance staff in government organizations (focusing on the requirements of the new public administration system).

7. **Australia (AusAID)**

Australia is providing support to the State Audit Board in association with the ADB-supported governance reform program. The support involves provision of auditors from the Victorian Auditor-General’s Office to the State Audit Board. The Australian auditors are working alongside the SAB auditors to review the financial statements that have been prepared for the five pilot agencies.

8. **Japan (JICA)**

Japan is supporting the implementation of a Public Investment Program (PIP) Budgeting Process in MOFE through the provision of consulting advice and training (September 1998 to March 2001).

9. **European Union (EU-TACIS)**

Strengthening of the Academy of Management (AOM) 800,000; May 1999 – November 2000. The aim of this project is to improve the effectiveness and efficiency of public administration through provision of short- and long-term training of public administrators. The curriculum includes modules on financial management.

10. **Germany (GTZ)**

Germany is providing support to the State Audit Board through a project titled Institutional Strengthening of the State Audit Board (SAB) [DM 3 million; April 1998 to March 2001]. The project aims to improve state auditing (methodologies and technical skills) by providing equipment, training and short-term experts. The project involves training (seminars and study tours) staff from the SAB, MOFE and AOM.
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
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

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

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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

<table>
<thead>
<tr>
<th>Roles and Responsibilities</th>
<th>Organization</th>
<th>Funding Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MICPA</td>
<td>ARB</td>
</tr>
<tr>
<td><strong>Certified Public Accountants (CPAs)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sets CPA qualification standards</td>
<td>✔</td>
<td>...</td>
</tr>
<tr>
<td>Conducts CPA examinations</td>
<td>✔</td>
<td>...</td>
</tr>
<tr>
<td>Grants and records CPA titles</td>
<td>✔</td>
<td>...</td>
</tr>
<tr>
<td><strong>Auditing Firm Licencing</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receives and processes applications</td>
<td>✔</td>
<td>...</td>
</tr>
<tr>
<td>Issues and revokes licenses</td>
<td>✔</td>
<td>...</td>
</tr>
<tr>
<td>Roles and Responsibilities</td>
<td>Organization</td>
<td>Funding Sources</td>
</tr>
<tr>
<td>----------------------------------------------------------------</td>
<td>--------------</td>
<td>-----------------</td>
</tr>
<tr>
<td></td>
<td>MICPA. ARB</td>
<td></td>
</tr>
<tr>
<td><strong>Accounting and Auditing Standards</strong></td>
<td></td>
<td>Budget funding</td>
</tr>
<tr>
<td>Develops work plan</td>
<td>...</td>
<td>✓</td>
</tr>
<tr>
<td>Provides technical secretariat services</td>
<td>✓</td>
<td>...</td>
</tr>
<tr>
<td>Reviews standards</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Approves and issues standards</td>
<td>...</td>
<td>✓</td>
</tr>
<tr>
<td>Monitors enforcement</td>
<td>...</td>
<td>✓</td>
</tr>
</tbody>
</table>

**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.”

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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 T A N o. 2964-M O N : 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,
ISSUES AND RECOMMENDATIONS

- 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 Aimag (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. 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).

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

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50 ADBTA 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

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\(^{51}\) ADB TA No. 2964-M ON: 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.


FINANCIAL MANAGEMENT AND GOVERNANCE ISSUES IN MONGOLIA
IX. Main Deficiencies and Action Plan

Mongolia has made progress in reforming accounting and auditing arrangements to meet the needs of a mixed-market economy but inappropriate institutional arrangements impede further development. This study has identified gaps and weaknesses, which may be categorized as follows:

- Those deficiencies that are better able to be resolved with external assistance.
- Those deficiencies that are able to be resolved without the need for external assistance.

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Supporting the reassignment of institutional responsibilities, the establishment of a statutory body with accounting-standard responsibilities, and development of related legislative changes</td>
<td>High</td>
<td>✔</td>
<td></td>
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<tr>
<td>Supporting the establishment of a Continuing Professional Education (CPE) System for CPAs</td>
<td>High</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Support for training accountants in the countryside</td>
<td>High</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Assisting the development of a project to train accountancy lecturers and professors in modern methods of teaching accountancy</td>
<td>High</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>The excessive requirements for audits and the short timeframes in which those audits must be performed</td>
<td>High</td>
<td>×</td>
<td></td>
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<tr>
<td>----------------------------------------------------------------------</td>
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<td>-----------------</td>
</tr>
<tr>
<td>The granting of CPA titles to unqualified accountants (i.e. after the first of three exams is passed)</td>
<td>High</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>The retention of CPA titles by accountants who qualified under low criteria from 1993 to 1997</td>
<td>High</td>
<td>✗</td>
<td>✓</td>
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<tr>
<td>Supporting a comprehensive review of reference and training materials and the development of new materials</td>
<td>Medium</td>
<td>✓</td>
<td>✓</td>
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<td>Assisting with the provision of training on IAS and Financial Reporting to personnel from the Banking Supervision Department of the Bank of Mongolia</td>
<td>Medium</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Supporting the continuation of public education initiatives on the nature and uses of financial information</td>
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<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Assisting in a project to develop a supervision regime for the activities of accounting and auditing firms</td>
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<td>✓</td>
<td>✓</td>
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<tr>
<td>Supporting the establishment of subsidiary membership categories in MICPA (e.g. accounting technician and public sector accountant)</td>
<td>Medium</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>The lack of recognition given to the public sector accounting policies developed under the governance reform program</td>
<td>Medium</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>----------------------------------------------------------------------</td>
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<td>-------------------</td>
<td>----------------</td>
</tr>
<tr>
<td>The withholding of CPA certificates from the 18 candidates who qualified under the ADB-supported training scheme</td>
<td>Medium</td>
<td>×</td>
<td>✓</td>
</tr>
</tbody>
</table>
References


Appendixes

Appendix 1. Interviewees

Appendix 2. RETA-5877 (Regional Study) Information
1. Study Phases
2. Phase I: Case Study On Accounting and Auditing
3. Phase II: Ulaanbaatar Workshop
4. Phase III: Development of Reference Materials
5. Phase IV: Formulation of Action Plan
6. Consultation

Appendix 3. Administrative and Institutional Arrangements
1. Introduction
2. Executive, Legislative and Judicial Arrangements
3. Structure of the State
4. Organs of State Authority
5. Banking Sector
6. Listed Companies

Appendix 4. Regulatory and Legal Framework
1. Introduction
2. Legislative Process
3. Public Sector Legislation
4. Private Sector Legislation
Appendix 1. Interviewees

Aspects of financial management and governance were discussed with the following people.

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Celilio P. Lim III</td>
<td>Manager</td>
<td>Arthur Andersen</td>
</tr>
<tr>
<td>Larry Ruddell</td>
<td>Managing Director</td>
<td>Arthur Andersen</td>
</tr>
<tr>
<td>Barry Hitchcock</td>
<td>Resident Representative</td>
<td>Asian Development Bank, Mongolian Resident Mission</td>
</tr>
<tr>
<td>Shelly Warner</td>
<td>Program Manager</td>
<td>Mongolia-Australia Capacity Building Program (AusAID)</td>
</tr>
<tr>
<td>S. Selenge</td>
<td>Senior Economist</td>
<td>Bank of Mongolia</td>
</tr>
<tr>
<td>S. Demberel</td>
<td>Chairman and CEO</td>
<td>Chamber of Commerce and Industry</td>
</tr>
<tr>
<td>Bill Bikales</td>
<td>Project Advisor</td>
<td>Economic Policy Support Project</td>
</tr>
<tr>
<td>B. Bat-Amgalan</td>
<td>Senior Liaison</td>
<td>Erel Company</td>
</tr>
<tr>
<td>David Hepburn</td>
<td>Resident Representative</td>
<td>EU-TACIS</td>
</tr>
<tr>
<td>Khurelbaatar</td>
<td>Project Advisor</td>
<td>EU-TACIS: Academy of Management Strengthening Project</td>
</tr>
<tr>
<td>Richard Lucking</td>
<td>Project Advisor</td>
<td>EU-TACIS: Academy of Management Strengthening Project</td>
</tr>
<tr>
<td>Ts. Khulan</td>
<td>Office Manager</td>
<td>Harrods Minerals Mongolia Ltd</td>
</tr>
<tr>
<td>J. Uranbileg</td>
<td>Project Coordinator</td>
<td>Ministry of Finance and Economy</td>
</tr>
<tr>
<td>R. Batjargal</td>
<td>Head</td>
<td>Ministry of Finance and Economy, Accounting and Auditing Division</td>
</tr>
<tr>
<td>B. Bolormaa</td>
<td>Specialist</td>
<td>Ministry of Finance and Economy</td>
</tr>
</tbody>
</table>
APPENDIXES

L. Dashdorj  Head  Ministry of Finance and Economy, Fiscal Policy Division
Silan Nadarajah  Treasury Advisor  Ministry of Finance and Economy
Manmohan Ruprai  Team Leader  Ministry of Finance and Economy. ADB TA No. 3031-MON: Development of Procurement Legislation and Guidelines

L. Dondog  President  Mongolian Institute of Certified Public Accountants
B. Sainjargal  Chairman of Accounting Department  Mongolian National University
B. Sukhbaatar  Vice President  NIC Company
Ts. Gungaanyambuu  Director  Nimm Audit Company
Ch. Davasuren  Auditor  Nimm Audit Company
L. Enkh-Amgalan  Chairman  Professional Accounting Council
A. Enkh-Amgalan  Project Director  Public Administration Reform Project
B. Namkhajantsan  Entity Coordinator  Public Administration Reform Project
Ch. Narantuya  Entity Coordinator  Public Administration Reform Project
O. Lhagvasuren  Public Accountant  Public Administration Reform Project
Tsenddaag  Accountant  SocoTamstag Mongolia Inc.
N. Khurlee  Senior Financial Inspector  State Audit Board
D. Tserendash  Head of Second Division  State Audit Board
<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Organization</th>
</tr>
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<tbody>
<tr>
<td>Bob W oolgar</td>
<td>Audit Advisor</td>
<td>Office of the Auditor-General of Victoria (AusAID)</td>
</tr>
<tr>
<td>Michael Rossbach</td>
<td>Project Coordinator</td>
<td>Support to the State Audit Board German Technical Cooperation</td>
</tr>
<tr>
<td>D. Terbishdagva</td>
<td>General Director</td>
<td>TBD Anduud Limited</td>
</tr>
<tr>
<td>D. Sukhjargalmaa</td>
<td>Assistant Resident Representative</td>
<td>UNDP</td>
</tr>
<tr>
<td>Johnathan Simon</td>
<td>Project Director</td>
<td>UNDP Enterprise Restructuring Project</td>
</tr>
<tr>
<td>David Levi</td>
<td>Senior Advisor</td>
<td>UNDP Enterprise Restructuring Project</td>
</tr>
<tr>
<td>U. Gankhuyag</td>
<td>Economic Officer</td>
<td>World Bank</td>
</tr>
<tr>
<td>B. Tsolmon</td>
<td>Operational Officer</td>
<td>World Bank</td>
</tr>
<tr>
<td>R. Lynn Ground</td>
<td>Resident Representative</td>
<td>World Bank</td>
</tr>
</tbody>
</table>
Appendix 2. RETA-5877 (Regional Study) Information

Study Phases

The study had four broad phases as follows:

Phase I – Mongolian Case Study on Accounting and Auditing Support and Structures
Phase II – Ulaanbaatar Workshop (9 June 2000)
Phase III – Development of Reference Materials
Phase IV – Formulation of Action Plan

Phase I: Case Study On Accounting and Auditing

This phase involved the examination of Mongolia's current accounting and auditing structure and systems. It also (i) analyzed Mongolia’s 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.

A structured questionnaire, that covered the following areas, was used to collect descriptive information:

(i) Legal and regulatory framework (public and private sector)
(ii) Accounting infrastructure (professional bodies and accounting standards)
(iii) Institutional issues (public and private sector)
(iv) Government and administrative arrangements
(v) Financial reporting (public and private sector)
(vi) Accounting and computerization (public and private sector)
(vii) Accountancy education and training
(viii) Budgeting (public sector)
(ix) External audit (public and private sector)
(x) Previous studies and initiatives on financial management and governance.

Barry Reid conducted the fieldwork for the study with the able assistance of G. Tserenkhand, from 13 May to 8 June 2000. Further research assistance was provided by D. Bayasgalan in September and October 2000. Financial management and governance arrangements were discussed with representatives from: the Ministry of Finance and...
Economy, the State Audit Board, other government organizations, present and former cabinet ministers, professional accounting and auditing bodies, private sector businesses, tertiary institutions, bilateral donors, and multilateral financing institutions. A list of interviewees is attached as Appendix 1.

Phase II: Ulaanbaatar Workshop

Issues arising from the study were discussed and debated at workshop held in Ulaanbaatar on 9 June 2000. Dr R. Batjargal, Head of the Accounting Division of MOFE, chaired the workshop. Francis B. Narayan, Lead Financial Specialist, ADB, participated in the workshop as a resource person and provided overall guidance with respect to the objectives of the Study. Fifty-seven participants, representing the following organizations, attended the workshop:

- Arthur Andersen
- Bank of Mongolia
- EU-TACIS
- Financial Inspection Agency
- General Department of National Taxation
- Golomt Bank
- GTZ
- International Monetary Fund
- JICA
- Ministry of Finance and Economy
- MICPA
- Mongolian Professional Accounting Council
- Mongolian Stock Exchange
- NIM Audit Company
- Securities Commission
- State Audit Board
- State Property Committee
- State Service Council
- Trade & Development Bank
- UNDP
- USAID
- World Bank

Phase III: Development of Reference Materials

In phase III, reference materials on IAAS were developed. In developing these materials, consideration was given to; (i) alternative transition systems and associated benchmarks as well as underlying institutional prerequisites, and (ii) production of these materials in local languages.

Phase IV: Formulation of Action Plan

Phase IV assessed the roles that ADB and other funding agencies played in improving the current situation in the selected DMCs. The roles
included policy intervention, projects and program assistance, and mobilization of cofinancing resources to address the identified problems and weaknesses. This activity was undertaken in close consultation with the Government, regulatory authorities, representatives of the accounting and auditing professions, and other local interest groups and funding agencies. At this stage of the RETA, the commitment in principle of each selected country to implement the findings and recommendations of the study was agreed. The findings of the RETA were disseminated and debated at a conference in Manila on 16-18 October 2000 and the developed action plan was finalized for implementation.

Consultation

Drafts of this report were provided to a variety of organizations and individuals for review. We would very much like to thank the following people for their helpful comments on report drafts: L. Dondog, President of MICPA; D. Bayasgalan, Ministry of Finance and Economy; R. Woolgar, Victorian Auditor-General's Office (Australia).
Appendix 3. Administrative and Institutional Arrangements

Introduction

This appendix reviews government and administrative arrangements in Mongolia. It begins by describing executive, legislative, and judicial arrangements then proceeds to discuss the structure of the state, organs of state authority, the banking sector, and listed companies.

Executive, Legislative and Judicial Arrangements

Mongolia is a unitary state in accordance with the 1992 Constitution. The President is Head of State. The Executive Branch comprises the Prime Minister, the Cabinet, and the President. The Legislative Branch is a unicameral parliament (Ikh Khural) comprising 76 members elected by popular vote. The Judicial Branch is independent.

The President is elected for a four-year term, and the next presidential election will be held in summer 2001. The Prime Minister and the Cabinet are selected and approved by the legislature, in consultation with the President, for a four-year term. Parliament members are elected every four years; the last parliamentary election was held in July 2000.

The Supreme Court serves as the Appeals court for the People's and the Provincial courts, but has rarely overturned lower court verdicts. Judges are nominated by the General Council of Courts for approval by the Parliament.

Structure of the State

The Law on Administrative and Territorial Units and their Governance 1992, together with the Law on Government 1993, and the Constitution, are the primary legislative sources for the structure of the state (Figure 3 refers).

Organs of State Authority

The State Great Hural

The State Great Hural is the highest organ of state power and the only body that has legislative power. The State Great Hural represents, and upholds, the interests of all the citizens and the state. The State Great Hural is the only competent body for adopting, supplementing, and
amending laws, and determining the basis of the state policy both domestic and foreign.

The State Great Hural defines the state's financial, credit, tax, and monetary policies, determines the guidelines for the country's economic and social development, approves the Government's program for action, the State Budget, and the report on its execution. As the supreme law-making authority in the country, the State Great Hural controls the public finances.

The President and His Office

The President, by Constitution, is the Head of the State and embodies the unity of the Mongolian people. The President is responsible to the State Great Hural. The prerogative rights of the President include vetoing against parts or whole of laws and other decisions made by the State Great Hural, instructing the Government on issues within the frame of his competence, representing the State with full power in foreign relations, reporting on and submitting proposals concerning vital issues of foreign and domestic policy, etc.
The President’s Office creates the necessary conditions for implementing the full authority and decision making by the President. The duties include: providing information and advice, publicizing the President’s activities, creating conditions for the cooperation between highest legislative, executive, and judicial bodies; drafting resolutions, decrees, vetoes, and other statements to be issued by the President, managing correspondence and documentation, preparing budget estimates, etc.

The Judiciary

In accordance with the Constitution, only courts can exercise the judicial power. The judicial system includes three levels, the Supreme Court being at the highest, and Aimag and Capital City Courts, Sum, inter-Sum and District Courts, as well as specialized Courts at a lower level. The activities of Courts are financed from the state budget.

The Constitution states the independence of judges providing for the General Council of Courts to ensure such independence. The judges shall be subject only to law and free from interference from any citizen or civil officer. The General Council of Courts selects the judges, protects their rights, and ensures that the conditions of guaranteeing the independence of judges are in place, but does not interfere with decision making by the judges.

The Parliamentary Secretariat

The Parliamentary Secretariat supports the activities of the State Great Hural and its Standing Committees. The duties include: providing methodological assistance, preparing, and organizing meetings of the State Great Hural, publishing laws and decisions, providing the members with information, communicating citizens, and organizations.

Standing Committees

Standing Committees of the State Great Hural are groups of Members of the State Great Hural appointed by the State Great Hural to consider and report on specific issues. The State Structure Standing Committee and the Budget Standing Committee are the committees most directly involved in the public sector financial management system.
The Government
The Government is a collective of portfolio ministers chaired by the Prime Minister. The Government, as the highest executive body, is directly accountable to the State Great Hural. It implements its Program of Action approved by the State Great Hural and reports on the progress of its achievement to the State Great Hural. The Government makes Government policy decisions, which are then implemented by Ministries and Agencies.

Cabinet Ministers
There are 11 portfolio ministers each of whom is serviced by a Ministry.

The Cabinet Secretariat
The Cabinet Secretariat renders legal and technical services in organizing the activities of the Government and assists in coordinating activities of central state administrative bodies (Ministries and Agencies) as well as in directing the local government.

Ministries
There are eleven ministries:
- Ministry of Finance and Economy
- Ministry of Defense
- Ministry of Infrastructure Development
- Ministry of Education, Culture and Science
- Ministry of Health
- Ministry of Labor and Social Welfare
- Ministry of Nature and the Environment
- Ministry of External Affairs
- Ministry of Justice and Internal Affairs
- Ministry of Trade and Industry
- Ministry of Agriculture and Food

Agencies
There are 47 Government agencies within the responsibility framework of the Prime Minister, Cabinet Secretariat and 11 Cabinet Ministers, comprising 15 coordinating and 32 implementing agencies.
Currently 51 agencies are established and functioning. Agencies implement government strategy within the Portfolio. Twenty-six agencies are financed from the central or local budget, 16 are self-financing agencies, and nine have mixed sources of financing.

<table>
<thead>
<tr>
<th>Responsibility</th>
<th>Coordinating</th>
<th>Implementing</th>
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<tr>
<td>Prime Minister</td>
<td>2</td>
<td>2</td>
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<tr>
<td>Cabinet Secretariat</td>
<td>..</td>
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<tr>
<td>Minister for Finance and Economy</td>
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<tr>
<td>Minister for Justice and Internal Affairs</td>
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<tr>
<td>Minister for Nature and the Environment</td>
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<td>2</td>
</tr>
<tr>
<td>Minister for Defense</td>
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<td>1</td>
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<td>Minister for Education, Culture, and Science</td>
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<td>Minister for Infrastructure Development</td>
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<tr>
<td>Minister for Agriculture and Food</td>
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<td>2</td>
</tr>
<tr>
<td>Minister for External Relations</td>
<td>..</td>
<td>1</td>
</tr>
<tr>
<td>Minister for Health</td>
<td>1</td>
<td>..</td>
</tr>
<tr>
<td>Minister for Labor and Social Welfare</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Minister for Trade and Industry</td>
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<td>4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15</strong></td>
<td><strong>32</strong></td>
</tr>
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</table>

Local Government Bodies

It is estimated that there are 3,434 public entities, of which 256 are financed from the central budget. The remaining 3,178 are local government bodies. Most of the local government entities are schools, hospitals, cultural centers, kindergartens, veterinary clinics, and others that deliver basic services to the local population. Local government bodies are currently financed from the local budget.

Governors appoint managers of these bodies. However, most aimags, except for Ulaanbaatar city and Orkhon (Erdenet), Darkhan, Tuv, and Selenge aimags, receive subsidies from the central budget. Moreover, there is widespread criticism about the lack of mechanism and coordination to implement the Government policy at the local level.

State Enterprises

The state enterprise sector represents a major part of the Mongolian economy. The Government of Mongolia has launched a far-reaching
privatization program but the State still holds substantial shares in the biggest enterprises. As a whole, poor management, poor investment decisions, and political interference characterize the sector.

Table 11: Local Government Entities by *Aimag*

<table>
<thead>
<tr>
<th>Aimag</th>
<th>No. of Sums</th>
<th>Aimag &amp; Sum Governors Offices</th>
<th>Hospitals</th>
<th>Vet. Clinics</th>
<th>Schools</th>
<th>Kindergarten</th>
<th>Culture Centers</th>
<th>Other*</th>
<th>Total</th>
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<tbody>
<tr>
<td>Arkhangai</td>
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* Others comprise:
  - Assemblies: 21
  - Sport Centers: 27
  - Meteorological Centers: 69
  - Theaters: 20
5. Banking Sector

Mongolia currently has 12 licensed commercial banks with a network of over 500 branches, sub-branches, and cash counters. Eight of these are either fully or partially owned by the State. Foreign (minority) participation is limited to one bank. The banks have about 65,000 customers and employ approximately 4,000 people. The three largest banks – Trade & Development Bank (TDB), SB, and Golomt Bank – held 80 percent of all bank assets as of December 1999. Net lending in the banking system is T 53.6 billion ($53 million) backed by total assets of T 182 billion ($182 million). Capital adequacy is 20 percent.

Mongolia’s ratio of M 2 to GDP, a measure of the role that money plays in the economy, has declined over the past few years to only 18 percent, on par with Africa’s poorest countries. Intermediation spreads are extremely high. The interest rate for short-term domestic currency loans is 47 percent per annum, and the average interest rate paid on domestic deposits is about 24 percent per annum. These high intermediation spreads are symptomatic of general distress in the banks reflecting the increased risks of default, high operating costs, and the high proportion of non-performing loans.

For the past 10 years, since the end of communism in Mongolia, the banking system has inflicted more costs than benefits upon the economy. Governments have collapsed over the issue of banking reform and the outcome has been a financial system dominated by rotten state banks and a welter of poorly supervised private ones. A recent political consensus has emerged that should enable the state to get out of banking, bring foreigners in, and improve supervision. In early 2000, the Bank of Mongolia forced the two worst performing State-owned banks -- the Investment and Technological Innovation Bank and the Reconstruction Bank - into liquidation. The latter possibly had the world’s highest bad-loan ratio of over 95 percent.

Primary Sources:
ADB has identified the following issues of concern (in addition to high intermediation spreads):

- Regulatory Supervision. Political pressures together with lax lending, limited supervision capabilities, and weak legal enforcement for debt recovery have aggravated the problem of under-capitalization. The Government has incurred fiscal restructuring costs of approximately 5 percent of GDP over the past four years. The Central Bank has supplemented this direct support by allowing banks to maintain large interest spreads, and to retain profits.

- Weak Governance and Internal Controls in the Banking System. Banks are poorly managed and have limited commercial orientation. State-owned banks are operated by managers who were trained under the old system based on directed lending and subject to political interference. Newly privatized banks are owned by individuals who view ownership as a means to finance their business activities over any other priority. In addition to insider lending, lending to related parties continues.

- Limited Incentives Framework to Support the Development of Strong Banks. The development of a core, sound, banking system is constrained by lax bank entry conditions, weak regulatory oversight and the absence of a bank exit strategy. In September 1999, the minimum bank paid-in capital requirement was raised to T1 billion ($1 million) from T400 million ($400,000).

- Limited Reach of Financial Services. The banking sector provides a narrow range of financial instruments usually limited to demand, savings and time deposits on the liabilities side and government bonds and treasury and central bank bills on the assets side.

6. Listed Companies

The government-owned Mongolian Stock Exchange (MSE) was established in 1991. A major impetus was provided by the privatization of SOEs during 1991–1994 with the allocation of SOE investment coupons to over 2 million citizens for trading at the MSE. About 12 million citizens became shareholders of 470 companies. The Securities Law of Mongolia was enacted in September 1994, following which the Mongolian Securities and Exchange Commission (MSEC) was established.

At present, there are 418 companies listed on the MSE, of which 324 are privatized enterprises. The market capitalization, as of February
2000, is $37 million close to 4 percent of GDP, down from $53 million in early 1998. Trading activity has declined sharply in the past year, as evidenced by the drop in daily trading from $25,000 in September 1998 to about $13,000 in January 2000. The poor state of the banking system is cited as one of the primary reasons for the drop in stock market activity.
Appendix 4. Regulatory and Legal Framework

1. Introduction

The Mongolian legal system is a blend of the Russian, Chinese, Turkish, and more recently western, systems of law. There is no constitutional provision for the judicial review of legislation. Mongolia’s legal framework has been largely re-created in the past 10 years with 300-500 new laws being passed. The transition has not been without problems. Laws are sometimes contradictory, accessing legislation has been problematic, and laws are not necessarily obeyed. While there have been improvements in the first two areas, there has been a marked deterioration in adherence since 1998.

This appendix describes the laws and regulations that pertain to financial management and governance.

2. Legislative Process

The legislative process starts with the drafting of a bill. The Justice Ministry usually reviews the Bill before it is submitted to the Parliamentary Secretariat, which provides it to Parliament. Once the Bill is tabled in Parliament, it is referred to the appropriate multi-party Parliamentary Standing Committee(s) for review and approval. Following approval by the Standing Committees, the Bill is sent back to Parliament. It is read and debated during three readings, with a vote taken at each stage. If approved on its third reading, the Bill is signed by the Speaker of the House and, in the absence of a Presidential veto, becomes law.

3. Public Sector Legislation

Law on Administrative and Territorial Units 1992

This law regulates the governing system, competencies, and principles of the functioning, structure, establishment, reorganization, and dissolution of Mongolian administrative and territorial units.

Budget Law 1992

This law is administered by the Ministry of Finance and Economy and 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 requires that draft budgets be submitted to the Ministry of Finance and Economy by 20 August each year. The Ministry of Finance and Economy is required to submit the budget to the Government by 20 September and the Government is required to submit the budget to Parliament by 1 October. Budget governors are required to submit quarterly reports within 15 days of the end of the quarter and within 25 days of the year end. Quarterly reports on budget implementation should be submitted to Parliament.

The Budget Law 1992 focuses on interactions between budget organizations. With the exception of broad categories of revenues and expenses, the budget law is silent on reporting bases, disclosure requirements, and reporting formats.

Law on Government 1993
This law establishes the principles of activities, duties, and the structure and composition as well as the working organization of the Government and regulates matters pertaining to the relationship of the Government with other organizations.

Central Bank Law 1993
This law applies to the Bank of Mongolia's powers, administration, organization, operations, and state monetary policy. The main objective of the Bank of Mongolia, under this law, is to ensure stability of the Togrog currency and, within this objective, to promote balanced and sustained development of the national economy, through maintaining the stability of money, financial markets, and the banking system.

The Law requires that the Bank of Mongolia submit a monetary policy statement to Parliament before 1 October of each year. It requires that the Bank of Mongolia establish procedures for issuing regulations, and issue regulations and instructions and undertake supervision and enforcement activities relating to the licensing of banks, the requirements of banks, the maintenance of adequate capital and liquid assets, improving the security of the banking system, and regulation of banking activities.

The Law gives the Bank of Mongolia substantial powers of supervision including, rights of entry and rights of examination. It establishes the independence of the Bank from the Government. The Central Bank Governor is appointed by Parliament for a six-year term.
The Bank of Mongolia is required to publish a monthly bulletin on monetary statistics and to inform the public about changes in monetary policy and the state of financial markets every quarter. The Bank of Mongolia is required to prepare an annual report, in accordance with Generally Accepted Accounting Practices, and to table that report in Parliament, once it has been audited.

State Audit Law
This law applies to the audits of Ministries, Agencies, capital city and Aimag, Sums, authorized administrative bodies and local self-governing bodies.

The State Audit Law reflects a centralized accounting regime and provides the State Audit Board (SAB) with investigative powers. The State Audit Board is not given a specific mandate to conduct financial attest audits. The SAB can impose fines of T5,000–50,000 for infringements.

Law on Government Service 1995
The purpose of this law is to establish and regulate the government service of Mongolia, the classification and principles of government service, government posts and their requirements, the legal status of government employees, and the conditions, procedures and guarantees for their performance.

The Law on Government Service 1995 has incentives for staff development through rewarding people on performance and skills. It also sets job classifications at five levels with four grades each (Articles 7 & 20). The granting of ranks occurs formally through a centralized process that takes into account the length of service (Article 20). Government employees are eligible for housing subsidies, family-member education, medical services, training and retraining. Employees are rewarded for attaining higher levels of education.

Public Procurement Law 2000
This law regulates matters relating to the preparation of tender documents, advertisement, opening of tenders, evaluation of tenders, award of contract with purposes of procurement of goods, works, and services by all Procuring Entities for State and Local needs, and levels, compositions of Tender Committee and control over its activities. ADB
TA No. 3031-MON supported the development and implementation of this law.

Proposed Legislation

A comprehensive law on public sector management and finance was developed with ADB support and submitted to Parliament in October 1997. In late 1999, the first reading of the law received 78 percent support. If enacted, this law will affect many of the above laws.

4. Private Sector Legislation

Auditing Law 1997

This law is administered by the Ministry of Finance and Economy and the Professional Accounting Council (an agency of the Ministry of Finance and Economy) and applies to the determination of auditing principles, the administration of the process for registering auditing companies, and the process for granting CPA qualifications.

The Auditing Law 1997 requires that accountants pass three CPA examinations. The CPA title is granted at the first stage, but the qualification is valid only for two years by which time the accountant must have passed the second stage. Once the second stage examination is passed, the CPA title is valid for five years. If the accountant has not passed the third examination within five years, the title is withdrawn. Those who pass the final examination receive the title for life.

Article 7 of the Auditing Law 1997 requires that banks, insurance companies, any other financial institutions, listed companies (and those planning to list), joint ventures, fully- and partially-owned state enterprises, and all companies with capital of at least T30 million ($30,000) must submit to an annual independent audit.

Civil Law 1991

This law, which is administered by Justice Ministry and the Courts, governs commercial and contractual relations.

Banking Law 1996

This law is administered by the Bank of Mongolia and applies to the licensing of banks and banking activities, the revocation of licenses, the establishment of general principles of management, organization, and banking activities, and the regulation of relations concerning the
supervision, reorganization, receivership and liquidation of banks. The Law should be read together with the Central Bank Law 1993 in that it specifies that banks must prepare financial statements.

Accounting Law 1993
This law is administered by the Ministry of Finance and Economy and regulates the maintenance of accounting records and the preparation of balance sheets by business entities and organizations.

The Accounting Law 1993 allows businesses to maintain their records in either single, or double-entry, form. It states that the Minister of Finance and Economy shall approve standard accounting forms and methods for business entities and organizations. Article 3.3 requires that accounting forms and methods be consistent with International Accounting Standards.

Financial statements are required to 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 must be prepared, certified and submitted by 20 February.

The Minister for Finance and Economy is responsible for providing professional and methodological directions for accounting in Mongolia. The Law provides for the establishment of a unit for this purpose in the Ministry of Finance and Economy. A non-executive Professional Accounting Council was to be established under the Ministry of Finance and Economy. It is responsible for assisting with the development of accounting forms and methods, improving accounting and reporting systems, training and improving the qualifications of accountants.

Professional training institutions shall issue practicing certificates for accountants. A business entity or organization may undertake training for the accounting profession with the permission of the Ministry of Education and the Ministry of Finance and Economy.

Securities Law 1994
This Law regulates relations in respect to the fairness of issuance of the securities for the purpose of accumulation of financial resources, buying and selling of securities, providing depository, clearing and settlement services, the protection of investors and oversight of the issuers, and other persons involved in the activities in the securities market.
Foreign Investment Law
The intent of this law is to encourage foreign investment, to protect the rights and property of foreign investors in Mongolia, and to regulate matters relating to the operations of business entities that foreign investors invest in.

Companies Law 1999
This law provides for the establishment of limited liability companies. The Law includes procedures for establishing companies and dissolving companies. It also provides for the dissolution of companies by the Court in the case of bankruptcy. Liquidators “shall be appointed by the body which resolves to dissolve a company and shall carry out the dissolution” (Article 15). At this point, the management authority transfers to the liquidators. The liquidators’ duties are prescribed and include the duty to discharge debts in accordance with priorities determined by the Law (Article 16).

Insolvency Law 1997
The Insolvency Law 1997 establishes procedures for dissolving companies and placing companies into receivership.

Taxation Laws
The following taxation laws are in effect:
- General Taxation Law 1992
- Personal Income Tax Law 1992
- Enterprises Income Taxation Law 1993
- Transportation and Self-Moving Vehicles Taxation Law 1992
- Firearms Taxation Law 1993
- Excise Taxation Law 1993
- Personal (Indirect) Income Tax Law 1993
- Tax Imposition, Tax Payment Control, and Tax Collection Law 1996
- Value Added Tax Law 1998