

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) MONGOLIA

ACCOUNTING AND AUDITING

March 10, 2008

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Executive Summary

This report provides an assessment of corporate sector accounting, financial reporting, and auditing requirements and practices within the enterprise and financial sectors in Mongolia. For purposes of this report, the corporate sector includes all private sector and state-owned enterprises. The report uses International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks and draws on international experience and good practices in the field of accounting and audit regulation to evaluate institutional capacity and make policy recommendations.

Since 1993, the World Bank and other development partners of Mongolia have provided financial and technical support to help Mongolia develop a legal framework, facilitate accounting education and adoption of IFRS and ISA by enterprises, constitute a new professional body, establish the examination of certified public accountants, and strengthen accounting and auditing in both public and private sectors. As a result, Mongolia has made significant changes from the old accounting for planned economic system to a new market-oriented accounting system that follows international good practices.

All key economic sectors in Mongolia rely on high-quality financial information, which requires high-quality private sector accounting and auditing. Reforms, liberalization, and deregulation to further enhance the Mongolian business environment must be supported by enhanced financial transparency and improved accounting and auditing practices. Increased levels of both foreign direct investment and domestic investment demand higher-quality financial information consistent with international standards. Continuing the strengthening and development of financial reporting, accounting and auditing, and the regulatory framework that governs them, will bring benefits to Mongolia and its citizens. In this context, this report sets out policy recommendations to enhance the quality of corporate financial reporting and foster a financial reporting platform conducive to sustainable private and financial sector growth, thus increasing access to global financial markets and other tools of the market economy.

The policy recommendations are based on the assumption that long-term country objectives include thorough modernization of the accounting and auditing professions, and development of a business environment conducive to preparation of transparent financial information compliant with international standards. As set forth in this report, achievement of these objectives requires further modernization and improvement of Mongolia's legal framework, institutions, accounting and auditing professions, as well as enhancement of its business culture and education system. However, policies should not be developed and enacted without giving due regard to a country's ability to carry out such policies (both in terms of capacity and resources); a relatively lenient rule that is robustly and consistently enforced is preferable to a rigorous one that is unenforceable, as the lenient rule can be progressively made more rigorous as the circumstances allow. The policy recommendations, while challenging, can be carried out in the short to medium term and are conducive to Mongolia's long-term objectives.

ACRONYMS AND ABBREVIATIONS

BOM	Bank of Mongolia
CES	Consortium of Economic Schools
CPA	Certified public accountant
FRC	Financial Regulatory Commission
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
MICPA	Mongolian Institute of Certified Public Accountant
MNAO	Mongolia National Audit Office
MNT	Mongolian <i>tugruks</i>
MOF	Ministry of Finance
MSE	Mongolian Stock Exchange
NBFI	Non-banking financial institution
NCSM	National Center for Standardization and Measurement
NGO	Nongovernmental organization
ROSC	Reports on the Observance and Standards of Codes
SME	Small and medium enterprises
SOE	State-owned enterprise
TACIS	Technical Aid to the Commonwealth of Independent States
NACHE	National Accreditation Council for Higher Education

This report was prepared from findings of a diagnostic review in Mongolia in October 2007 by a team from the World Bank. The team was led by David I. (Senior Financial Management Specialist, EAPCO) and comprised Zubaidur Rahman (Program Manager, OPCFM), Ochir Lkhagvasuren (Financial Management Analyst, EAPCO), and Badamgarav Otgonsuren (Consultant). The review was conducted through a participatory process involving stakeholders and country authorities.

I. INTRODUCTION

1. This assessment of corporate sector accounting and auditing practices in Mongolia is part of a joint initiative of the World Bank and International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC). The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting and includes both a review of both mandatory requirements and actual practice. For purposes of this report, the corporate sector includes all private sector and state-owned enterprises. The report uses International Financial Reporting Standards (IFRS)¹ and International Standards on Auditing (ISA)² as benchmarks and draws on international experience and good practice in the field of accounting and auditing regulation. The assessment uses a diagnostic template developed by the World Bank to facilitate collection of data. The data is complemented by the findings of a due diligence exercise based on a series of meetings with key stakeholders conducted by the World Bank team. The intended audience of the ROSC includes national and international market participants with an interest in the corporate financial reporting regime of Mongolia. An overview of the ROSC Accounting and Auditing and the detailed presentation of methodologies are available in the World Bank Group website.³

2. **Country Background.** A land of physical extremes and natural beauty, Mongolia has historically supported a widely dispersed and mobile population with strong nomadic traditions. Endowed with an area of 1.6 million square kilometers (which is larger than the surface area of France, Italy, and Spain combined) and a population of 2.56 million, Mongolia is the least densely populated country in the world. Landlocked in the heart of Asia between Russia and China, Mongolia experiences one of the coldest climates in the world with low, variable precipitation. Historically, this low productive, fragile environment supported a nomadic society with a dispersed population practicing mobile, extensive livestock herding. Perhaps more than any other place in Asia, these nomadic traditions still exist in Mongolia. More than one-third of the population continues to rely on semi-nomadic livestock herding as their primary source of livelihood, and many more depend on it for part of their income. The country adopted a new constitution in 1992 that embraces principles of democracy and private ownership. The country has become one of the most open economies in the region, setting free government-administered prices, exchange rates, and interest rates, as well as establishing a two-tier banking system and opening doors for private initiatives.

3. **Overall Economy.** Since the beginning of economic transformation in 1991, Mongolia achieved remarkable success in the transition toward market economy and has made significant strides in achieving macroeconomic stability and structural reforms.

¹ IFRS are issued by the International Accounting Standards Board, an independent accounting standard-setter based in London, United Kingdom. In April 2001, the IASB announced that it would adopt all of the International Accounting Standards issued by the International Accounting Standards Committee. In this report, the term IFRS also refers to IAS.

² ISA are issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants.

³ www.worldbank.org

Mongolia's gross domestic product rose by 22.7 percent in 2007, 8.4 percent in 2006, and 7.1 percent in 2005 primarily attributed by the improved agricultural output and favorable world market prices of key commodities such as gold and copper.⁴ Livestock herds increased from 25 to 40 million head from 2004 to 2007, and there was a large increase in revenues from the mining sector. The annual average inflation rate for 2007 was 9.0 percent which was 3.9 percent higher than annual average for 2006. Gross domestic product per capita for 2007 was US\$1,478 having almost tripled since 1995 when it was US\$528. Economic growth, although positive, is slow as the economy is constrained by its heavy dependence upon mineral resources and animal husbandry.⁵

4. **Governance.** Mongolia ranks 9 out of 62 countries for which firm level survey data was available and in terms of the percent of firms that believed corruption was their main obstacle.⁶ "The *World Bank Investment Climate Survey* (2006) results suggest that the prevailing perceptions of corruption in Mongolia's public sector may be a symptom of rising inequalities, and partly stemming from perceptions of lack of transparency and accountability in policy decision making and public sector governance. These survey results (World Bank 2006) indicate that unofficial payments, required for obtaining licenses, and the average bribe for different types of licenses, were high-estimated at around 40 percent of the official fees."⁷ Corruption, which has based its roots in a lack of transparency and accountability, is a severe impediment that has infiltrated into various sectors of Mongolian economy.

5. **Financial Sector.** Despite embarking on several reform measures, the financial sectors of Mongolia still remain vulnerable.⁸ The Bank of Mongolia (BOM) is responsible for implementing the Government's monetary and exchange rate policies, maintaining banking system stability, and supervising the activities of the banks and similar financial institutions. Although the establishment in 2006 of the Supervisory Board was an important step in the right direction toward the banking sector's autonomy and accountability, the Board's statutory role in reporting to Parliament is comparatively passive, and its resources are very limited. The quality of banking supervision, while improving, still entails a certain degree of forbearance, and important breaches of banking supervision laws and regulations have occurred without prompt corrective action by the Bank of Mongolia. Currently, there are 16 domestic commercial banks operating in Mongolia. Bank lending in Mongolia is almost exclusively collateral based, and immovable assets are the predominant form of collateral. The stringent collateral requirements are a direct indication that bankers perceive lending to be risky. The banking system in Mongolia is highly concentrated resulting in low-level financial intermediation. In addition to banks, there are 137 non-banking financial institutions

⁴ Monthly Bulletin of Statistics (Mongolia National Statistical Office, December 2007).

⁵ *Mongolia Sources of Growth*, Country Economic Memorandum, Report No. 39009 MN (PREM, East Asia and Pacific Region, World Bank, July 2007).

⁶ *Mongolia Sources of Growth*, Country Economic Memorandum, Report No. 39009 MN (PREM, East Asia and Pacific Region, World Bank, July 2007).

⁷ *Mongolia Quarterly*, a publication of PREM Sector Unit, East Asia and Pacific Region Vice Presidency, The World Bank, January 2008.; p. 18.

⁸ IMF Article IV, consultations, 2006, <http://www.imf.org/external/country/MNG/index.htm>.

(NBFI) and 570 savings and credit cooperatives in the indirect financing sector, saturating the small financial market. The weaknesses in the legal and administrative framework for bankruptcy and debt recovery make even collateral-based lending risky and costly. Poor governance and lack of adequate accountability make it difficult for banks to assess creditworthiness, forcing them to rely almost entirely on collateralized lending.

6. **Securities Market.** The Mongolia Stock Exchange (MSE) was established in Ulaanbaatar in 1991. At the end October 2007, 361 companies were registered in MSE, out of which 21 were 100 percent state owned, 39 were partially state owned, and 301 were private. A Securities Law was approved in late 1994 and went into effect in January 1995.⁹ The Securities Law governs the activities of the Stock Exchange, regulates who may issue securities, outlines how public offerings may be made, and sets down the duties and powers of such capital market players as clearinghouses, depository organizations, and underwriters. A Financial Regulatory Commission (FRC) was established in 2005 to administer the Securities Law and generally to oversee MSE activities.

7. **Private Sector.** A growing numbers of private enterprises, including conglomerates, have had a significant economic impact in Mongolia. Private interests dominate most key productive sectors, with the notable exception of infrastructure. Although emphasis and priorities of successive governments have differed, they have all been consistent in adopting policies to open the economy to private sector entrepreneurship. An institutional framework based on the rule of law and policies liberalizing trade, promoting competition, and encouraging foreign direct investment has supported the private sector. Most basic laws and institutions necessary in a market economy are in place. Privatization in Mongolia has been more rapid than in many other former centrally planned economies. Yet private sector development faces significant constraints. Weak legal definitions and a lack of harmonization are compounded by the absence of a reliable judiciary and limited familiarity with court adjudication. An inadequate supply of skilled managers, finance professionals, and technologists; and limited technological development lowers productivity and affects the comparative advantage of many enterprises. Capital market, insurance, and leasing operations do not yet play meaningful roles in the economy; and access to capital is limited, particularly for small enterprises. Private sector development, particularly in rural agriculture-based industries, is limited by poor infrastructure links to markets.

II. INSTITUTIONAL FRAMEWORK FOR ACCOUNTING AND AUDITING

8. This report outlines the legal principles applicable with regard to accounting, auditing and financial reporting and does not attempt to give anything more than an introduction to the issues. This report is not meant to be an exhaustive rendition of the law nor is it legal advice to those reading it. Annex A summarizes the various Mongolian

⁹ Data from Mongolian Stock Exchange.

laws that govern the statutory framework for accounting, auditing, and financial reporting.

A. Statutory Framework

9. **For-profit entities are regulated by the Company Law and the Law on Partnerships.** The Civil Code of Mongolia, which is a separate law, specifies legal entity types as either “for profit” or “non-profit.” A for-profit entity is established as either a partnership or company; a non-profit entity is established as an association, foundation, or cooperative. For-profit entities are regulated by the Company Law and the Law on Partnerships. The Company Law states that a company should be incorporated either as (a) open or joint stock company, whose shareholders’ capital is divided into shares that are freely traded by the public, or (b) closed or limited liability company, whose shareholders’ capital is divided into shares where the rights to dispose of such shares is limited by the company’s charter. The Law on Partnership states that a partnership should be formed whenever (a) all partners are fully liable or (b) some partners are fully liable.

10. **Legal status of an audit firm limits its liability.** Mongolian law allows audit firms to be incorporated in any legal form except joint stock and cooperative status. As such, all Mongolian audit firms choose to be formed as a limited liability company, which would limit their liability up to the share capital amount even if they have knowingly committed inappropriate actions. Audit firms obtain their license from the Ministry of Finance (MOF). Also, some audit firms are being controlled and managed by people who are not listed as the owners of the audit firm.

11. **Company Law states that executive management shall be responsible for company financial statements.** The company’s executive management directs daily operations within scope of the authority established under the charter of the company and the service agreement made with its board of directors or shareholders. Under the Company Law, a company is required to account and maintain books, keep related records, and prepare financial statements for submission to shareholders and other authorized persons.¹⁰ The Company Law states that a board of directors, which is responsible for approving the company’s financial statements, reports to the shareholders.

Accounting and Financial Reporting Framework

12. **The Accounting Law governs accounting in Mongolia.** The Mongolian Parliament passed the first Accounting Law in 1993 with subsequent amendments in 2002, 2003, and 2006. Mongolia has also adopted IFRS. The Accounting Law requires all for-profit and non-profit entities, including small and medium enterprises (SME), state-owned enterprises (SOE), and other entities to prepare financial statements in full compliance with IFRS. Most entities in Mongolia do not prepare financial statements in compliance with IFRS because it is too costly and too difficult, particularly for small and medium enterprises. The International Accounting Standards Board (IASB) has issued draft

¹⁰ Financial documentation includes balance sheet, income statement, cash flow statement, changes in equity statement, detailed list of all conflict of interest transactions, and notes to the accounts.

IFRS for small and medium enterprises. The Accounting Law stipulates double-entry accrual accounting and allows some deviation from IFRS due to Mongolia national context or situation with additional interpretation or explanation in the notes to the financial statements.

13. **The Banking Law and the Law on Non-Banking Financial Operations regulate banks and non-banking financial institutions, respectively.** While Ministry of Finance is responsible for development of overall accounting and auditing policy in the country, the Bank of Mongolia and Financial Regulatory Commission are responsible for issuing accounting regulations, consistent with IFRS, for banks and non-banking financial institutions. Table 1 presents a summary of required financial statements that must be prepared and submitted by law.

Table 1. Legally Required Financial Statements

<i>Type of organization</i>	<i>Balance sheet</i>	<i>Income statement</i>	<i>Cash flow statement</i>	<i>Statement of changes in equity</i>	<i>Notes to the account</i>	<i>Audit report</i>
Joint stock company	Yes	Yes	Yes	Yes	Yes	Yes
Limited liability company	Yes	Yes	Yes	Yes	Yes	Conditional
Banks	Yes	Yes	Yes	Yes	Yes	Yes
Insurance companies	Yes	Yes	Yes	Yes	Yes	Yes
NBFI	Yes	Yes	Yes	Yes	Yes	Yes
Cooperatives	Yes	Yes	Yes	Yes	Yes	No
Partnership	No	No	No	No	No	No

14. **Law on Partnership and Law on Cooperatives regulate partnerships and cooperatives.** These laws do not provide specific clauses on financial reporting requirements. However, according to the Corporate Tax Law, partnerships are required to file their financial statements with taxation authorities. Also the laws are silent about financial reporting and auditing requirements of nongovernmental organization (NGO) although the Law on Non-governmental Organizations requires filing annual operational reports to the Ministry of Justice and Internal Affairs.

15. **The Securities Law requires listed companies to follow the Accounting Law in preparing and filing of financial statements.** Listed companies are required to prepare and file semi-annual and audited annual financial statements to the Financial Regulatory Commission and the Mongolian Stock Exchange. Listed companies are required to publish their financial statements in accordance with FRC-issued format and regulations. The Securities Law is silent about responsibility of the MSE to disclose financial information received from listed companies to the public. The MSE voluntarily posts limited summarized financial information of those companies on its website (e.g., totals of current and non-current assets and liabilities of the balance sheet and few items from income statement). Therefore, investors are unable to obtain sufficient information

about the listed company's financial performance or position. Central depository of financial statements or financial information for public interest entities, including listed companies, is not available.

16. According to the Banking Law and the Law on Non-Banking Financial Operation, banks and non-banking financial institutions are required to follow the accounting regulations issued by BOM and FRC, respectively. The ROSC team observed that the accounting regulations issued by BOM and FRC are not regularly updated and some clauses of the regulations contradict IFRS. For instance, BOM allows some significant activities (i.e., contingent liabilities, including bank guarantees; line of credits; and inventories, including mortgaged assets, etc.) to be reported under “statement of off-balance activities.”

17. Using public media, banks are required to publish their financial statements. Financial statements are required to be submitted monthly, quarterly, and annually to the Bank of Mongolia. In practice, the published financial information is uninformative and summarized without sufficient details and does not use BOM-required indicators. When published in newspapers, it is presented in a non-user-friendly manner. In general, for entities that require their financial statements to be made public, it is usually done so in a summarized format providing limited information to the public. Although some larger banks publish their annual report, dissemination of the report to the public is not widespread.

18. The Law on Insurance requires insurance companies to prepare financial statements according to the Accounting Law and in compliance with IFRS. The Law on Insurance states that an insurance company should not prepare financial statements using cash basis of accounting, which is allowed for (with explanation in the notes) by the Accounting Law. Insurance companies are required by the Law on Insurance to submit their quarterly and audited annual financial statements to the FRC on dates specified in the Accounting Law and publish their audited financial statements to the public. In addition to submitting the audited annual financial statements, insurance companies should file (a) management report, (b) opinion of the auditor, (c) actuarial report on long-term insurance, (d) notes on significant events effecting company operations, and (e) other relevant documents required by the Law on Insurance to the FRC. Customers of insurance companies face considerable difficulty in obtaining sufficient information about the financial condition of their insurance company.

19. Most companies prepare financial statements with the purpose of submitting them to the taxation office only. Importance of the tax authorities as one of the influences on accounting and auditing practices is decreasing in Mongolia as demand for financial statements from other sources increases (e.g., demand from banks and other financial providers, shareholders, and potential investors). However, consistent with anecdotal evidence gathered from the ROSC-conducted financial statement reviews and interviews with various stakeholders, many preparers of the financial statements struggle to understand the key differences between general purpose accounting under IFRS and accounting for taxation purposes. Also, the Accounting Law states that, if a Government institute allows, an entity can apply cash basis of accounting for preparing financial statements. This contradicts IFRS but is the basis for preparing financial statements for tax purposes. Often the “tax numbers” are simply inserted into a standard chart of

accounts to produce the general purpose financial statements. One reason for this is that, until recently, entities were required to present their financial statements while submitting annual tax declarations and many believed (perhaps accurately) that dissimilar information in the financial statements from the taxation return would be treated as suspicious or even illegal by tax authorities. While tax authorities no longer require submission of the financial statements as a matter of course, they still have access to entities' financial statements and underlying financial records during tax audits. Confusion exists in Mongolia among practicing accountants who still view tax accounting as the primary purpose for preparing accounts and often lack a clear understanding of the differences between IFRS requirements and taxation regulations.

20. **Although not complied with by group companies, the Accounting Law requires them to prepare consolidated financial statements.** Although the Accounting Law states that group companies shall submit their consolidated quarterly and annual financial statements to MOF on specific dates of the year, compliance with this legal requirement is weak. The ROSC team observed that group companies tend to see little benefit in preparing IFRS-compliant consolidated financial statements. Besides, there is no sanction from relevant authorities if consolidated group financial statements are not prepared. In addition, the Company Law is silent about the requirements on preparation of consolidated financial statements.

Auditing Framework

21. **The Law on Auditing, State Audit Law, and certain sector specific laws and other regulatory documents govern the Mongolian auditing system.** The Mongolia auditing system is mainly regulated by the 1997 Law on Auditing and its subsequent amendments in 2001, 2003, 2005, and 2006; and State Audit Law. The Law on Auditing is regulated by MOF and the Mongolian Institute of Certified Public Accountants (MICPA) and is geared toward determination of auditing principles, organization, and administration for registering auditing companies, licensing certified public accountants and organizations in auditing, and supervising their activities. The Law on Auditing stipulates that only licensed audit companies can conduct audits. In 2002, the Parliament adopted the State Audit Law resulting in the transformation of the state audit organization from the previous State Audit Board into the Mongolia National Audit Office (MNAO). The State Audit Law dictates that MNAO as an independent agency reports directly to Parliament. The MNAO is responsible for annual financial statements audit of all government entities, including state-owned enterprises, and conducting performance audits of selected functions of budget entities. Several sector specific laws and regulations are also in place to regulate auditing activities in Mongolia. The Law on Auditing, Company Law, Banking Law, Law on Insurance, and State Audit Law establish audit requirements listed in Table 2 for all entities, except those that are exempt because they are below the thresholds.

Table 2. Mandatory Audit Requirements

<i>Type of entity</i>	<i>Mandatory audit requirements</i>
Listed joint stock companies	Board of directors must appoint an auditor who will conduct regular and specific audit of the company's financial position and economic

Table 2. Mandatory Audit Requirements

<i>Type of entity</i>	<i>Mandatory audit requirements</i>
	activities. The audited financial statements have to be submitted to the board of directors before they prepare the report to the shareholder's meeting.
Limited liability companies	Must appoint an auditor. Exemption threshold: if capital assets are not more than MNT 50 million (approximately US\$42,550)
Insurance organizations	Must appoint an auditor from the short-listed, FRC-certified audit firms. If an insurance company does not appoint its auditor, FRC has the right to appoint an auditor on behalf of insurance company
Cooperatives conducting savings and loan disbursement activities	Law on Cooperatives allows the Union of Cooperatives to conduct the audit on the savings and loan disbursement cooperatives.
Securities companies carrying out brokerage and dealer activities	Must self appoint an auditor.
Companies running investment funds, all funds described under civil code	Must self appoint an auditor.
Banks	Must self appoint an auditor, and audited financial statements shall be submitted to the Bank of Mongolia.
State-owned enterprises	MNAO and its representative offices in <i>aimags</i> (provinces) must conduct an audit of state-owned and local government-owned enterprises.
Political parties	Must self appoint an auditor.

22. **The Law on Auditing governs the audit requirement of small and medium enterprises.** According to Article 6.1.3 of the Law on Auditing, if a contractor demands an audit, all entities are required to have one done regardless of their size; this results in undue burden on SMEs.¹¹ Also, the SME audit exemption threshold is set at capital assets below MNT 50 million, or approximately US\$42,550. This threshold, seemingly low for the market place, results in unnecessary audits being conducted for small companies.

23. **The year-end deadline for filing of annual financial statements and the tight submission date for audit reports make compliance difficult for many entities.** The Accounting Law dictates that fiscal year-end for all enterprises must be December 31. This date does not consider the nature of businesses, thus creates the problem for some entities (agriculture business, universities, etc.) to fully and properly present their financial performance and position. Since all enterprises are required to submit both their audited financial statements and tax declarations to MOF and tax authority by February 10 of the following year, there is a large demand of audit services within a short time period. This audit deadline is actually harmful to the quality of the audit work as it does not allow sufficient time for audit completion. Audit firms have difficulty managing their resources during this period. The law does not allow entities to request extension of submitting their audited financial statements beyond the statutory deadline.

¹¹ According to Law on Auditing, *contractor* means administrative, legal prosecution, financial, taxation, banking, or customs authority who has a power of making decision to conduct an audit activity for a business entity or organization, board of directors, or shareholders holding more than 10 percent of company's common shares.

24. **The Law on Auditing does not provide any limitation on audit firms performing non-auditing services.** Law on Auditing treats both audit services and non-auditing services as “auditing operation,” which is not compliant with ISA, International Standards on Review Engagement (ISRE), and International Standards on Assurance Engagement (ISAE). Therefore, many audit firms are currently in conflict of interest situations. During the ROSC mission, the team found that in addition to performing audits, some audit firms are providing non-auditing services (consulting, accounting services, due diligence work, or tax preparation) to their clients. Since there is no regulation or effective oversight, audit firms are not barred from providing restricted non-auditing services to their audit clients.

25. **Although there are requirements, auditor independence from audited entities is not being practiced.** Due to lack of auditing oversight in Mongolia, no regulatory body is responsible for reviewing whether the audit firms are truly independent of their clients. The ROSC team noted instances when auditor independence was compromised by either the firm providing non-auditing services or an individual in the auditing firm being related to the audit clients.

26. **Audit firm rotation is required by the Law on Auditing.** According to the Law on Auditing, after an audit firm has been auditor of a company for 3 continuous years, the firm shall not audit that company in the following 3 years. This requirement does not seem reasonable or practical given the inefficiencies and the additional cost to the company due to the change in auditors and the limited supply of audit firms in Mongolia. In addition, the International Federation of Accountants (IFAC) pronouncements do not provide standards or recommendations for rotation of audit firms. The IFAC recommends rotation of senior engagement personnel after a certain number of years on the audit engagement.

27. **Law on Auditing mandates MNAO as the auditor for state-owned enterprises.** The December 2006 amendment to the Law on Auditing gives MNAO responsibility to conduct audit of state-owned enterprises. According to the State Audit Law, the MNAO has a right to determine the SOE audit fees so that the cost can be included in the state budget. The SOE audit fee set up by the Government is low compared to the resources required for a quality audit. Since MNAO does not have sufficient capacity to fully conduct the SOE audit, they usually outsource some audits to private audit firms. Because of the low fees, these private audit firms do not spend sufficient time conducting quality audits. Even though MNAO is responsible for the quality of outsourced audit work, they do not monitor the private firms.

28. **The Law on Cooperatives gives the Union of Cooperatives the right to conduct the audit on cooperatives.** A nongovernmental organization, the Union of Cooperatives monitors, supervises, and guides cooperatives, as established by the Law on Cooperatives. The Law on Auditing requires cooperatives engaged in savings and loans to be audited annually. Since the Union of Cooperatives has no expertise in accounting

and auditing nor does it have the required audit licenses, its opinions and recommendations on the financial statements of cooperatives are questionable.

29. **According to the Law on Auditing, all banks are subject to statutory audit.** Financial statements of a bank must be audited at least once a year and must be reported to its board of directors and supervision council, as well as the Bank of Mongolia.

30. **There is no legal requirement for compulsory professional indemnity insurance.** Audit firms are not insured against possible risk of litigation. No court cases have been reported in the past against audit firms for giving false opinion. Therefore, auditors do not see this as a risk and are not obtaining compulsory insurance. The Government recently took steps for accusing two audit firms for auditing misconduct. These two audit firms failed to inform the related Government bodies about financial fraud of MNT 14 billion (equivalent to US\$11,864,400) at a private commercial bank.

31. **According to the Law on Financial Regulatory Commission, the FRC provides the list of audit firms that are allowed to conduct audits of insurance companies.** According to this arrangement, an insurance company must select its auditor from the short-listed FRC-certified audit firms. If the insurance company does not appoint its auditor, FRC has the right to appoint an auditor on their behalf. However, FRC only provides introductory information to the auditors, and its capacity to monitor and review the auditor's performance is relatively inadequate.

B. The Accounting and Auditing Profession

Accounting Profession

32. **The accountancy profession is regulated by the Law on Auditing that gives the governing authority to the Mongolian Institute of Certified Public Accountant.** MICPA is a nongovernmental statutory organization established in March 1996. The Law on Auditing mandates MICPA to administer the professional accounting examinations; approve and enforce the Code of Professional Conduct and Ethics; provide certified public accountants (CPA) exam preparation courses; conduct continuing CPA professional education training; and provide audit firms with methodology, consultancy, and information. The MICPA has chapters and representative offices in every *aimag* (province) and district and in the Capital City. The elected assembly of delegates, who are voted in by MICPA members and hold a four-year term, is the MICPA governing body. The president of MICPA is elected at the assembly to a four-year term and is in charge of day-to-day activities. The assembly is assisted by four committees (ethics, training, accounting, and auditing) with five to seven members each, who are appointed by the representatives. A self-financing body, MICPA gets resources from membership, CPA examination, and training fees. The MICPA obtained associate membership of IFAC in November 2003. It is a full member of the Confederation of Asian and Pacific

Accountants (CAPA) and an associate member of ASEAN Federation of Accountants (AFA).¹²

33. **Only audit firms that obtain the audit license from MOF are authorized to act as statutory auditors.** To date, there are a total of 1,718 CPAs in Mongolia (355 CPAs holding life-time certificates because they passed all three levels of examination, 1,015 CPAs with a five-year certificate, and 348 CPAs with a two-year certificate). To become an auditor, the CPA should hold a five-year certificate and then join a MOF-licensed audit firm. The MOF has licensed 51 audit firms. Two international audit firms (KPMG and Ernst & Young) are licensed to practice in Mongolia. All CPAs and auditing firms become full members of MICPA upon registration. Sole practitioners are not allowed by the laws to join MICPA.

34. **Regulated by the Law on Auditing, the MOF-issued CPA certification is based on MICPA recommendations.** There are two kinds of qualifications required for individuals who are allowed to take the CPA examination: (a) individuals who possess a Bachelors degree in accountancy or equivalent degree and with at least two-years working experience at a business, faculty of professional institution, state organization, or auditing firm; or who graduate from professional universities and colleges before the enactment of the Law on Auditing (1997) and completed courses on financial and cost accounting, accounting information systems, auditing, and management advisory services; or (b) individuals who do not meet the above requirements but complete the required accounting credits, including training programs of universities, and have worked as an accountant for more than 4 years.

35. **The CPA program in Mongolia takes at least seven years to complete three stages of examination.** Once a person completes stage one and fulfills the working experience requirement, the person is allowed to be called a CPA and join the MICPA. Two years later with additional training given by MICPA, stage-one CPAs may take the stage-two examinations. Five years after successfully passing stage-two examinations, CPAs take additional training given by MICPA and are eligible to take the stage-three examinations. The current program prevents candidates from becoming lifetime-licensed CPAs in less than seven years, which is an unreasonable delay compared to industrialized countries where candidates can become CPAs within three years. In most industrialized countries, CPAs must have a certain amount of continued education courses and work experience to maintain their “active” CPA status. Without this, these CPAs are considered “inactive”.

¹² MICPA falls short of becoming a full member of IFAC still having to comply with Statements of Membership Obligation with regard to quality assurance, investigation and discipline, international education standards, and international standards-related practice statement, and other guidance from the International Accounting Education Standards Board (IAESB). IFAC Statement of Membership Obligation are designed to provide clear benchmarks to current and potential IFAC member organizations to assist them in ensuring high-quality performance by accountants worldwide. The IFAC obligations cover quality assurance, education standards, auditing standards, ethics, investigation and discipline, etc. For additional information, refer to <http://www.ifac.org/Compliance/index.php>.

36. **There are weaknesses related to the CPA examination and the prerequisite requirements.** The CPA examination does not extensively cover some critical subjects such as advanced auditing and corporate reporting. The CPA examination also is not computerized; consequently exam candidates have difficulty accessing past examinations, which are treated as confidential and essentially unavailable, in order to prepare for their examination. Additionally, university curriculum for undergraduate and postgraduate programs cover essential subjects such as financial accounting, cost accounting, managerial accounting, and intermediate accounting; none of which are recognized as exemption accreditation for the Mongolia CPA program. This means that examinees must take these courses from MICPA to receive credit.

37. **Besides MICPA, there are other professional organizations of accountants in Mongolia.** The Mongolian Institute of Internal Auditors, Mongolian Institute of Management Accountants, and Association of Mongolian Auditors are at an early stage of development due to lack of legal framework, governance and institutional arrangement, and technical capabilities. These institutes do not have international affiliations and professional qualifications and essentially provide training to interested companies and individuals.

38. **The size of accounting and auditing profession is currently small compared to the number of enterprises whose financial statements are subject to statutory audit requirements.** Mongolia has around 10,400 accountants working in over 50,000 enterprises (banks, financial institutions, private industries and corporations) and government entities. Also, there are 51 audit firms operating in Mongolia. Most banks and large foreign-invested entities are audited by the 2 international audit-firm network members (KPMG and Ernst & Young). Many local audit firms are relatively small, and their audit services are mostly engaged in assisting their clients to prepare tax-purpose financial statements. The ROSC team found that most small audit firms certify the financial statements by just putting a stamp without really conducting an audit. This violates the “due care and skill” requirements of the IFAC Code of Ethics.

39. **Mongolia recognizes CPA qualifications granted by other countries toward a Mongolia CPA license.** When a foreign CPA passes examinations on Mongolian business and taxation laws, they can then apply toward a Mongolia CPA license. Currently, six Malaysian CPAs are recognized as Mongolia CPA qualification holders. Since Mongolia provides this arrangement to foreign CPAs, reciprocal arrangement should be requested from other countries for Mongolian CPAs.

40. **Auditor quality is lacking oversight.** The Law on Auditing gives the Ministry of Finance responsibility for oversight of the auditing profession. The MOF currently conducts very limited auditor quality reviews; the actions undertaken by MOF, with regards to issuance and revoking of licenses, fall short of what is considered good practice. In addition to a more effective monitoring regime, international good practice involves both government and public oversight of the audit profession. While MOF is one of the stakeholders, it does not have the resources or the capability to adequately reflect the diverse interests of all stakeholders in the oversight of auditors.

a are former lecturers of Mongolian universities. They develop their audit knowledge by reading academic books, participating in donor-organized short courses and trainings, and gaining ad hoc experience from audit engagements. Although this is the available approach to deepen and broaden their professional knowledge, it is not an effective way to develop their acceptable skill level for a high-quality professional practice.

42. **Many audit firms are misrepresenting their number of qualified auditors.** Some small audit firms do not have an adequate qualified staff to conduct all their audits. Consequently, audits are sometimes being carried out by assistant auditors who do not have the necessary training and experience. There are also cases where audit firms are using the names of people who are not part of the firm or maybe residing outside of Mongolia. This practice of “joining a firm in name only” without actual involvement is a means to boost the size of a firm to gain business.

43. **The MICPA-adopted Code of Ethics, derived from the 1998 IFAC Code of Ethics for Professional Accountants, does not have regulatory status.** Only MICPA members are required to abide by the Code. The IFAC Code has been significantly enhanced especially where it relates to independence. Since the MICPA Code is a translation of an outdated IFAC version, it would be appropriate for MICPA to resolve discrepancies by developing its own Code and including teaching the Code in continuing education requirements for CPAs.

C. Professional Education and Training

44. **As a result of poor professional performance, the public and potential investors lack confidence in auditors’ reporting.** Mongolian auditors lack the necessary knowledge and experience to properly apply ISA. The auditing profession needs to boost its credibility and professional competence. Due to lack of resources and capacity, most audit firms do not have mentoring programs for new staff.

45. **English language skills among Mongolian auditors are extremely poor, disqualifying many auditors from the CPA program since English is one of CPA examination subjects.** Without adequate English language skills, most auditors are unable to seek information and knowledge from outside sources. Given that technical resources are primarily in English, most textbooks and Internet access, while vital resources, are not useful.

46. **Some audit firms provide limited internal training for their auditors.** Most audit firms do not have sustainable and well-educated internal trainers for providing continuing education training due to lack of capacity and financial resources. Training of

ng accreditation criteria and overseeing higher education programs through accreditation, its performance is inadequate due to lack of capacity. Each university has its own program and curriculum. Although the State Professional Inspection Agency conducts educational inspection for all universities and colleges, it only focuses on compliance of administrative rules and regulations rather than the quality of curriculum. The State Professional Inspection Agency lacks qualified experts in accountancy.

48. **Most universities and colleges develop their own accounting and auditing curriculum.** There are 47 universities, comprising 11 state and 36 private accounting and economic universities/colleges. Only 10 of these universities are members of the Consortium of Economic Schools (CES), a non-governmental organization. The Consortium helps its members in developing accounting curriculum. Minimum requirements and integrated professional curriculum of accounting professional qualification were developed and implemented under the TACIS program in Mongolia in 1999. Since then, no significant changes/updates have been made in key subjects and related curricula.

49. **Accreditations for either the organization or the program are given to higher educational institutions by the National Accreditation Council for Higher Education (NACHE).** The organizational accreditation review mainly focuses on the organization's resource capacity and management capability to provide academic education, while the program accreditation reviews the subjects and the related curriculum. NACHE usually delegates economic and accounting program accreditation review activities to the Consortium of Economic Schools. The ROSC team found that since 2000, only 7 of the CES member universities/institutes and 4 accounting programs have been accredited. Since the Consortium of Economic Schools is voluntary and a self-regulating organization, only the member schools follow its recommendations.

50. **Students studying accounting and auditing in Mongolia universities do not receive sufficient training in IFRS and ISA.** There are weaknesses in university accounting curricula, especially as it relate to international accounting and auditing standards. Accounting curricula do not sufficiently cover auditing, ethics, IFRS and ISA, and any related updates. Only three universities teach IFRS and ISA as a separate course. In addition, most accountants cannot obtain sufficient continuing professional education after graduation from university as no institution offers such training.

51. **Universities lack the resources found in good textbooks and instructors.** Professors translate foreign accounting and auditing textbooks into Mongolian text, but what few textbooks are available are out of date and many professors lack the English or other foreign language skills to translate effectively the text into Mongolian. Relying on

donated textbooks, most university libraries do not carry current IFRS, ISA, and other accounting/auditing-related textbooks. University and college lectures earn lower wages in comparison to what is available to them working with private companies, leaving a dearth of talent in the classrooms.

52. **There is no oversight on the quality of the numerous short-term accounting courses being offered to the public.** Some private enterprises offer short-term (mainly 45 days to 3 months) training courses on accounting and issue certificates to their graduates. There is no legally backed institutional arrangement to monitor these activities. The key stakeholders in the country are of the view that poor quality courses are being offered by many of these training centers.

D. Setting Accounting and Auditing Standards

53. **The National Center for Standardization and Measurement (NCSM) is solely responsible for approving and issuing all national standards in Mongolia, which is unusual compared to other country practices.** The NCSM is a government agency under the Deputy Prime Minister. Although NCSM usually does not develop the standards that are issued, it has the sole right to change and publish national standards, which creates problems for other professional bodies that must develop and improve the standards and regulations. The NCSM does not have sufficient qualified experts on accounting and auditing. The NCSM has many subcommittees that review the various sector-related standards. Specifically, there is the NCSM accounting standard-setting subcommittee but its working arrangement is not sustainable and relationship with other stakeholders is weak. Note that the NCSM accounting standardsetting subcommittee is chaired by the Director of MOF Accounting Policy, Methodology Department.

54. **The Accounting Law stipulates that the Ministry of Finance acts as the state policymaking body for accounting and auditing.** The MOF is responsible for organizing the translation of IFRS into Mongolian language and is also responsible for development of IFRS-based national accounting standards and guidelines. The MOF does not have sufficient staff or budget for either task. The MOF-supported, donor-funded translation function is currently performed by a group of external translators and reviewers and has been quite slow. The 2003 editions of IAS, IFRS, and International Public Sector Accounting Standards were translated into Mongolian language but the translation did not include the glossary, interpretations, and other IASB-required items. Note that IAS and IFRS are required in Mongolia and were adopted as part of the amended 2006 Accounting Law and Law on Auditing. Also, the time gap between translation and adoption of newly issued and revised international standards significantly hinders the continued development of accounting and auditing practice in Mongolia. Translators are also challenged with finding a common understanding of definitions and interpretation of entirely new concepts. It is appropriate not to develop new national standards given that adopting international standards rather than developing national standards is the current trend among developing countries and is encouraged by the international financial community.

55. **Many users of company financial information do not value IFRS.** As long as there is no demand or appreciation for IFRS-based financial accounting and reporting, the corporate sector will not adopt it. The MICPA and MOF have not taken any significant actions to educate the business community on the benefits of adopting IFRS. The MOF introduces translated IFRS to the public through short training seminars. However, these sessions are not in-depth and not sufficient for accountants to understand IFRS application.

56. **The MOF develops and issues accounting methodology and guidance for private sector.** Detailed, IFRS-consistent accounting methodology/instructions and reporting formats for private sector entities, were issued by MOF in 2003. No further updates have been issued even though new IFRS standards are continuously rolled out by the IASB. The MOF accounting specialists in each aimag (province) and district of Ulaanbaatar are responsible for reviewing financial reports from all enterprises in their respective aimag or district. However, they do not have the time, personnel, or technical knowledge to determine whether the enterprises are following IFRS.

57. **Accountants, auditors, and tax inspectors do not fully understand how to use new forms and formats.** The MOF adopted a reconciliation form in 2002 and introduced a new tax reporting format for annual income and expenses in 2003. However, accountants, auditors, or tax inspectors do not fully understand how to use them. Company accountants fear tax penalties and thus maintain accounting records on a tax basis with slight adjustments for IFRS compliance. This practice results in inaccurate financial reporting, decreased transparency, and disputed tax assessments.

58. **The BOM and FRC issue separate accounting regulations for banks and non-banking financial institutions, respectively.** These regulations are not timely or updated in line with changes made in IFRS. The BOM updated their regulations in 2004. The BOM and FRC focus on operational/regulatory compliance requirements rather than accounting and financial reporting.

59. **The FRC recently developed and submitted National Standards on Insurance.** The FRC submitted to the NCSM for their approval standards relating to financial reporting of insurance business in line with International Standards on Insurance.

60. **The Law on Auditing and State Audit Law require that both private and state auditors apply International Standards on Auditing.** The 2003 IAASB edition of ISA was translated into Mongolian. However, the time gap between translation and adoption of newly issued and revised ISA significantly hinders continued development of auditing practice in Mongolia. Under donor-funded projects, two audit manuals were developed. The first is the *Application of ISAs, the Policies and Procedures* for directors of audit firms issued to auditors. The second is the *Financial Audit Manual* issued to the MNAO auditors. The MICPA and MNAO introduced Mongolian translated versions of ISA to the state and private sector auditors. The MICPA organized training to private sector auditors and MNAO did the same for its state auditors. However, due to lack of

resources and skilled trainers, these training sessions were not effective, resulting in auditors not fully understanding ISA principles.

61. **The Law on Auditing contains inconsistent provisions on the standards to be followed for conducting an audit.** While article 8.1 of Law on Auditing requires audit firms to follow ISA, article 8.2 requires national auditing standards to be approved by the competent authority in accordance with the principles of the ISA. The Law does not specify who should be the competent authority to develop and approve such national auditing standards.

E. Enforcing Accounting and Auditing Standards

Enforcing accounting (financial reporting) standards

62. **The enforcement of appropriately prepared and filed financial statements varies depending on various governing laws.** In general, the Accounting Law stipulates that all entities will file financial statements, in accordance with IFRS, to designated agencies. In cases of failure to file financial statements within a specified period, the state inspector or judge shall impose fines on responsible person of the entity or company. The BOM and FRC have the same authority as well for banks and non-banking financial institutions, respectively. The enforcement of the regulations for commercial banks and non-banking financial institutions focuses on compliance with operational/regulatory requirements. Relevant agency supervisors conduct examinations with focus on ensuring whether the reports were or were not filed but not whether the financial statements were actually in compliance with IFRS.

63. **Many companies do not follow the laws that provide enforcement provision for preparation and filing of financial statements in accordance with IFRS.** There are approximately 380 listed companies, but only 160 of them have submitted their 2006 financial statements to MSE. Some listed companies are not transparent in disclosing their financial position, but FRC and MSE have not taken effective actions to enforce compliance with the laws. Review by MSE is limited to checking mathematical accuracy, completeness of document components for filing, and other areas without any real technical review for IFRS compliance. There are no MSE-imposed sanctions on these listed companies if they do not comply with IFRS requirements.

64. **There is no central depository of public interest entities' financial statements for public access.** All companies submit their financial statements to MOF, which uses them primarily for statistical analysis. However, financial statements of public interest entities are not made public. With responsibility for registering entities and providing state registration number, the State Registration Agency under the General Department of National Taxation does not play any role in collecting the data from the entities and providing information to the public. A draft law on state registration has been developed, and conceptual discussions were held within government agencies in consultation with the Mongolian President. According to the draft law, the State Registration Agency would have more responsibility for gathering and providing public interest data.

Enforcing auditing standards

65. **Mongolia’s laws and regulations do not provide a robust enforcement and oversight framework in the area of accounting and auditing.** The laws do not cover pertinent crucial issues (i.e., roles and responsibilities of the various agencies, penalties for noncompliance, etc.), thus leaving room for misinterpretation.

66. **The MICPA has introduced an audit quality assurance system to its members.** There is no legislative requirement on the oversight of audit quality in Mongolia. Although the MICPA appears to have introduced an audit quality assurance system, it has no legal authority for this approach. Since MICPA is a membership body, it may not be a good approach for Mongolia to give MICPA a mandate for oversight of audit profession. Self-regulated arrangements without independent oversight causes difficulties for investors and stakeholders as they consider such arrangements do not allow public interest to override the profession’s vested interests.

67. **The MOF, with input from MICPA, sometimes conducts reviews of audit firms.** This MOF review is more focused on compliance of laws and regulations rather than ISA compliance. Several disciplinary sanctions were imposed by MOF on 14 audit firms over the last 5 years. Since the MOF did not publish a report on its activity, the nature of the cases and the infractions were not available to the public. The ROSC team found that audit licenses of 6 audit firms were revoked because of false certification of financial statements and 8 audit firm’s audit licenses were temporarily suspended for 3 to 6 months for other infractions. It seems that the law is silent about the basis for taking disciplinary actions against the auditors. Neither MOF nor MICPA have legal power to impose fines or penalties since penalties, fines, and other sanctions are implemented by the state court decision or State Professional Inspection Agency.

68. **No effective practice exists within MICPA to ensure compliance with a code of ethics.** There is an Ethics Committee established within MICPA that develops a code, conducts investigation, and makes conclusion on disputes and breach of ethics by CPAs and audit firms. The MICPA Ethics Committee consists of voluntary representatives from audit firms and professional accountants. This arrangement has the potential for conflict of interest. There have been no sanctions or actions issued by this committee against auditors who did not follow the code of ethics.

69. **Established by the Government in 2005, the FRC oversees non-banking financial institution, security market, and insurance operations in Mongolia.** The FRC has four departments dealing with insurance, security market, non-banking financial institutions, and savings and credit cooperatives policy and issues. However, the FRC does not have sufficient legal framework, resources, and capability to effectively monitor companies in these industries. The Law on Non-banking Financial Operation requires NBFIs to submit annual audited financial statements to their board of directors and FRC. If auditors find any irregular activities, insolvency of the company, or other issues resulting in negative audit opinions (qualified or disclaimer) during the course of an

audit, the auditors must report immediately to the FRC. However, this obligation is not practiced, and no such cases have been reported to date.

70. **The auditors' opinions on financial statements of commercial banks are not compliant with IFRS.** The ROSC team observed that accounting regulation issued by BOM and adopted by commercial banks are not consistent with IFRS. However, the auditors still express an opinion that these financial statement presentations are IFRS compliant.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

71. The following compliance gap analysis focuses on IFRS compliance found in statutory and voluntary/contractual (e.g., required by a lender) financial statements in order to identify any shortcomings in accounting standard monitoring and enforcement in Mongolia. Mongolia does not have its own national accounting standards so a “standards gap” analysis is not required. All entities are required to adopt and utilize IFRS but actual implementation by all entities does not exist.

72. The ROSC analysis shows that the quality of the financial statements prepared by the majority of enterprises in practice falls far short of IFRS, the reporting requirements in the statutory framework. The MOF recently conducted a survey which shows that 85 percent of all entities prepare financial statements in compliance with IFRS. However, the ROSC team observations contradict these survey results. Accounting for only certain items, ROSC-sampled entities do not fully account in accordance with IFRS. The review of sample financial statements and discussions with small and large companies, commercial banks, and academics show critical gaps between the treatment of balances with regards to the IFRS definitions:

- **IAS 12 *Income Taxes*.** Deferred taxes are a new concept for Mongolia. Deferred taxes are not understood by many and are thus not applied in preparation of financial statements.
- **IAS 16, *Property, Plant and Equipment*.** Mongolia companies capitalize repair and maintenance costs as per paragraph 8 of IAS 16. However, related depreciation expense is not recognized as associated with the capitalized repair and maintenance costs. Also, Mongolian companies do not refer to IAS 16, paragraph 43, which states that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. Most companies capitalize the full amount of expense into the initial cost of the fixed asset and depreciate it according to the remaining useful life of the fixed asset. Also, most companies do not assess a residual value for its fixed assets. Furthermore, effective January 1, 2007, and as stated in the amended Tax Law, companies are no longer allowed to recognize expense, for tax purposes, of yearly repair and maintenance cost exceeding 5 percent of the net book value of that asset. As such, many companies do not recognize this permanent book to tax difference.

- **IAS 16, *Property, Plant and Equipment*, and IFRS 6, *Exploration for and Evaluation of Mineral Resources*.** A significant portion of the Mongolian companies do not set aside funds for provision for restoration in order to avoid taxation issues. According to the Mineral Laws of Mongolia, annual amortization of the provision for restoration is required and should be established in order to restore the site to its original condition.
- **IAS 16, *Property, Plant and Equipment* – Fair Value.** Companies that choose to revalue their fixed assets are governed by IAS 16, paragraph 34, which states that fixed assets should be revalued every three to five years. Companies tend not to revalue their assets even though impairment may seem likely due to the condition of the fixed asset. This is mainly due to the ambiguity arising from the Mongolian Taxation Law, which is silent with regards to the revaluation of fixed assets. Ambiguity arising from the act of revaluation of assets is on whether differences arising from the revalued amount and the initial cost are to be recorded as permanent or temporary differences under the Mongolian Taxation Law
- **IAS 38, *Intangible Assets*.** Mining companies in Mongolia account for expenditures and research expenses spent in the development of potential mining areas, projects, etc. This is because companies do not follow up on reports to ascertain these amounts are directly attributable toward the development of the mining project as oppose to just research costs.
- **IAS 27, *Consolidated and Separate Financial Statements*.** Group companies in Mongolia, which have control interests in its subsidiaries generally do not comply with IAS 27. Due to this, and the fact that companies believe that subsidiary profits will be subject to the tax of the parent company, led directors of parent companies to not consolidate their accounts to avoid unnecessary taxes. They are unaware that tax is not made on a group basis but rather at the company. In addition, various companies do not consolidate their financial statements due to the time and costs associated with preparing consolidated financial statements.
- **IAS 24, *Related Party Transactions*.** Companies do not track or disclose related party transactions.
- **IAS 41, *Agriculture*.** Most companies are not aware of this standard and do not value their livestock. (Some Mongolian companies have small livestock herds in their accounts). Instead, livestock are valued at costs rather than fair value as required by IAS 41.

73. **In addition to overcoming deviation from IFRS, entities need improvement in internal controls and general accounting. The ROSC team observed the following:**

- ***Non-existence of a debtor's aging analysis.*** This may assist in identifying long outstanding debtors and allow for provisions to be made for doubtful debts.

- **Non-existence of an inventories aging analysis.** Inventory aging analysis indicates to management which inventory may be obsolete and needs to be addressed.
- **No tagging of fixed assets.** Assets should be tagged and periodically reconciled to the fixed asset register to ensure they are appropriately safeguarded.
- **Company share certificates are not timely updated for changes.** Changes in structure and ownership of a company are usually not updated, which may lead to potential unnecessary disputes.
- **Long outstanding bank accounts.** Mongolian companies do not close inactive bank accounts on a timely basis.
- **Disaster recovery plan.** Large companies do not have a disaster recovery plan in the event of a disaster. A disaster recovery plan provides a business continuity plan to reduce any potential financial losses.
- **Whistleblowing activities.** Whistleblowing activities should be implemented by companies in order to identify potential fraud within companies.
- **Continuation and training.** Staffs of companies should be equipped with adequate and updated knowledge of accounting to properly do their job.
- **Accounting system.** Proper accounting systems should be adopted by companies to ensure a systematic book keeping process.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

74. **The ISA-compliance level by audit firms is determined by the Audit Manual, which was developed in a 2003 project with the Asian Development Bank.** The Audit Manual requires an auditor to make an assessment of risk and internal controls and develop an audit strategy, testing controls, transactions, and balances that would allow the auditor to express an opinion on the financial statements. However, since 2003, the International Auditing and Assurance Standards Board (IAASB) has promulgated several ISA statements while no updates have been made to the Audit Manual. In addition, the MICPA does not have sufficient qualified staffs to regularly update the Manual and other guidelines.

75. **ISA is not consistently adopted by Mongolian auditors.** Audit firms associated with international accounting firm networks and other larger firms generally tend to follow ISA. Small audit firms find it costly to comply with ISA. In fact, most auditors lack technical expertise in applying ISA and enforcing IFRS compliance. Because university curriculums are not oriented toward practical application of the ISA and because continuing education is not effectively provided, auditors face difficulty in applying standards. Many auditors do not know how to assess risks and internal controls, determine materiality levels, maintain proper working papers, and conduct other pertinent auditing activity.

76. **The ROSC team found that most firms do not have written internal policies and procedures.** Some audit firms do not have their own written internal policies and procedures, while others do. However, for those that do, they are usually not comprehensive and do not comply with the IFAC requirements.

77. **The audit process consists of compiling client data and formatting the financial statements.** Audit services provided by firms, particularly in aimags, consist primarily of “converting” the presentation of client’s accounting statements into IFRS format. As such, they are not acting as independent auditors.

78. **Many corporate entities lack understanding of the concept and purpose of auditing.** Most corporate entities view audits of financial statements as documentation certifying the entity has complied with the laws, including tax authority requirements. As such, they expect auditors to correct presentation of their financial statements to comply with legal requirements. In essence, they see the auditors as their external “bookkeepers”. Thus, most auditors do not conduct audits in accordance with ISA.

79. **Lack of oversight by a company supervisory board on an auditor’s performance is usual.** Although the Company Law requires joint stock companies to have a supervisory board to monitor company’s management activities, review financial statements, conduct supervision at the demand of shareholders, and protect stakeholder’s interest, these boards do not ensure external auditors fulfill their responsibilities to conduct good audits. The Company Law allows Mongolian joint stock companies to have at least one member on its supervisory board. As a result, most joint stock companies choose to have a supervisory board with one or two members predominately from the majority shareholders. As such, these supervisory boards end up supervising themselves.

80. **Actual practices differ from ISA.** The review of sample audited financial statements and related discussions conducted by the ROSC team with small and large audit firms show shortcomings adversely impact the quality of auditing practices in Mongolia:

- Third party confirmations are rarely used because of the low response rate.
- Planning and risk assessment is either not performed or poorly documented.
- Audit materiality is not determined according to ISA and not considered when performing the audit.
- A 100 percent review or checking of supporting documents is mostly performed by auditors of smaller audit firms.
- Second partner reviews are not generally conducted.
- Working papers are not properly maintained and conclusions issues are not well documented or supported. Also, no audit trails documented.
- Most firms make little or no effort to monitor compliance with the ethical standards.
- The auditors do not pay any attention to opening balances to ensure that it does not contain material misstatements affecting the current date balances of the financial statements.

V. PERCEPTIONS ON THE QUALITY OF FINANCIAL REPORTING

81. **Public perceives that entity financial statements are confidential.** Financial statements of most entities are not available to the public because most companies do not include their financial statements in their annual report and do not present them on their website. In addition, the public believes that all entities prepare different sets of financial statements for different purposes (i.e., one for tax office, another for internal use). Financial statements are only submitted to government agencies, such as tax office and MOF, and are usually not made available to the public.

82. **Lenders and investors are skeptical that audited financial statements of corporate entities are truly presented and fairly stated.** Banks rely on cash flow projections and internal set of financial statements, which are prepared for presenting their true financial position. Therefore, it is common practice for banks and investors to use an “internal” set of financial statements for their assessment rather than financial statements submitted to tax office. Interviewees noted that quality and accuracy of financial statements would not improve until the capacity of accountants and auditors is further developed and that regulatory oversight, including very tough sanctions and penalties, is enforced for ensuring compliance with IFRS and ISA.

VI. POLICY RECOMMENDATIONS

83. The principal objective of this ROSC assessment is to assist the authorities and other stakeholders in strengthening the financial and non-financial sectors’ accounting, financial reporting, and auditing practices, as a means to support certain relevant strategic objectives for Mongolia, including:

- Enhancing the business climate and bolstering domestic and foreign direct and portfolio investment in the private sector;
- Strengthening the stability and competitiveness of the banking and non-banking financial sectors; and mitigating the risk of crises due to loan collection problems and weak capital base;
- Encouraging greater transparency in both state- and privately owned enterprises, thus allowing shareholders and the public-at-large to assess management performance and influence its behavior;
- Aligning the normative and legal framework in the area of financial reporting, accounting, and auditing with the best international practices;
- Facilitating SME access to credit by encouraging a shift from collateral-based lending decisions to lending decisions based on the financial performance of the prospective borrower, thereby supporting growth in the SME sector; and
- Helping to ensure that the financial reporting and auditing rules applicable to different types and sizes of entity are appropriate to the needs of those entities and the users of their financial statements.

84. The recommendations of this ROSC are interrelated and mutually supportive, and require a holistic approach to implementation. They are designed to collectively improve the financial reporting environment in Mongolia. For example, good accounting standards are jeopardized if auditors do not understand how to translate them into journal entries;

and a rigorous statutory and regulatory framework is unlikely to be effective if it is not enforced. Additionally, some recommendations will not have an immediate effect but still remain of high priority if the financial reporting environment in Mongolia is to be upgraded to international standards within a reasonable timeframe.

85. **Mongolia should establish a multidisciplinary National Steering Committee to champion and coordinate the accounting and auditing reforms.** The National Steering Committee should be comprised of representatives from BOM, FRC, MOF, MICPA, MSE, NBFI, commercial banks, insurance companies, audit firms, and academia. The Steering Committee should advise policymakers and regulators with regard to the implementation of the ROSC recommendations. Based on the successful experience of other countries, this report recommends that the Steering Committee develop a country strategy and a detailed country action plan that clearly sets out the key actions and allocates responsibilities for implementing the necessary reforms. The country action plan should include an itemized budget indicating the resources necessary for successful implementation; and the Government, policymakers, and development partners should work together to secure those resources so as to achieve the common goal of enhancing the quality and availability of financial information in Mongolia.

86. The policy recommendations, while challenging, can be carried out in the short to medium term and are conducive to Mongolia's long-term objectives. They fall into four key areas:

- Statutory and legal framework,
- Standards settings and enforcement,
- Development of the accounting and auditing profession, and
- Professional education and training.

In order to ensure that proposed recommendations would be effective, the Government of Mongolia should consider an appropriate regulatory structure/system for accounting and auditing with the relevant bodies and their roles, responsibilities, and authorities; and the relationships between the bodies clearly set out. This structure/system should include an independent oversight entity with sufficient technical competency and regulatory rights to oversee the auditing profession.

Recommendations for statutory and legal framework

87. **Revise Accounting Law and Law on Auditing.** The Accounting Law and Law on Auditing should be revised thoroughly to (a) set up an appropriate framework for standardsetting and legal backing, (b) outline effective monitoring and compliance framework, and (c) place greater emphasis on financial reporting and filing. This should be focused on enhancing the statutory framework governing accounting, auditing, and financial reporting taking into account other laws and regulations, including Company Law, Banking Law, Law on Financial Regulatory Commission, Taxation Laws, Law on Non-Banking Financial Operation, Cooperative Law, and others. This legal rationalization should highlight the overall principles and purposes of financial reporting, consistent with IASB framework for the presentation and preparation of financial

statements. Detailed forms and requirements should be dealt with at the level of secondary regulations.

88. **With regard to revising the Accounting Law**, the following functions should be considered:

- Comprehensive review of all legislation related to accounting, auditing, and financial reporting should be done in order to identify contradiction or conflicting requirements.
- Full adoption of IFRS and ISA without modifications should be mandatory requirements for all public interest entities in Mongolia. These public interest entities should be defined through an analysis of the business structure in Mongolia.¹³ Where the regulators need additional information for prudential supervision purposes, this should be an addition to the IFRS. In this regard, separate issuance of accounting regulations (e.g., by BOM and FRC) should cease.
- Specify simplified financial reporting requirements for small and medium enterprises. The thresholds should be provided by law. National financial reporting standards should be in conformity with IASB-issued SME financial reporting standards.
- Mandatory obligation to prepare and file consolidated financial statements for group of companies should be clearly redefined by the laws for fulfilling the criteria of public interest entities.
- The Government may need to consider introduction of different financial year-ends for different entities depending on their nature and business operational cycle.
- The Accounting Law as well as Law on Auditing should provide a legal backing to establish a national standardsetting body, which could be called the National Accounting and Auditing Standards Committee. Members of this Committee could comprise representatives from MOF, BOM, FRC, MICPA, MSE, MNAO, and NCSM; and academic professors from larger universities. Full power in development, issuance, and adoption of standards should be granted to the National Accounting and Auditing Standards Committee by law. All secondary regulations should be consistent with standards IFRS, ISA, and national standards issued by the National Accounting and Auditing Standards Committee in order to harmonize accounting- and auditing-related legislation and policies. The law

¹³ Public interest entities may be defined by the nature of the business, the size, and the number of employees; or by the corporate status by virtue of their range of stakeholders. Examples of public interest entities might include banks, insurance companies, investment funds, social insurance funds, other funds described in civil code, listed companies, large enterprises including state-owned enterprises, non-banking financial institutions, savings and credit cooperatives, professional bodies participating in security market activities such as companies carrying out brokerage and dealer activities, political parties and etc. The large enterprises may be defined as follows: individual enterprises and groups of enterprises that meet 2 of 3 following thresholds should be considered as public interest entities – (a) total number of employees exceeding [a number to be decided in consultation with various stakeholders]; (b) total assets on the balance sheet exceeding [amount to be decided in consultation with various stakeholders]; and (c) total turnover exceeding [amount to be decided in consultation with various stakeholders].

should provide an appropriate governance structure and level of independence to the proposed National Accounting and Auditing Standards Committee.

- The law should require public interest entities and parent body of group companies to file their annual individual company and consolidated financial statements to appropriate agency within a reasonable period after balance sheet date. Also it is recommended to establish appropriate location for central depository of public interest entities financial statements in order to facilitate public access to their financial statements.
- The law should provide regulators with adequate authority to set appropriate sanctions for violating applicable accounting standards and rules and filing requirements for ensuring effective monitoring and enforcing actions.
- There should be effective harmonization on accounting, auditing, and financial reporting legislation with the tax framework. Guidance would need to be given on how to reconcile the accounting profit/loss with the taxable profit/loss. In the absence of guidance, entities often intermingle tax and accounting standards when preparing financial statements.

89. **With regard to revising the Law on Auditing**, the following recommendations should be considered:

- An audit of legal entity and/or consolidated financial statements should be required only when there is a public interest for such an audit irrespective of the entity's legal form.
- An option to adopt "ISA Plus" model, whereby – while ISAs are adopted in full – additional requirements relating to the scope of the statutory audit (e.g., an additional prudential requirements for banks and insurance companies) might be imposed. In general, the audit of financial statements should be carried out in accordance with ISA and other related pronouncements issued by IFAC.
- The law should provide legal backing for establishment of effective arrangement for audit quality assurance system. In this regard, law should be amended to provide MICPA with the right and obligation to review the quality of audit firms. In parallel with this, the Government oversight on overall effectiveness and appropriateness of the audit quality assurance system, including supervision of MICPA activities with respect to the review of audit firms, needs to be in place within government structure.
- Auditing and non-auditing services should be separately defined in the law in accordance with ISA. In particular, the legislation should prohibit auditor's involvement in preparing financial statements of audit clients.
- Audit exemption threshold should be carefully reviewed and redefined based on qualitative and quantitative factors. Only public interest entities should be subject to statutory audit. Also the contractors' power to demand an audit specified in existing Law on Auditing should be removed.
- The law should allow entities to submit audited financial statements readily available to the public within a reasonable period after the balance sheet date.
- The requirements for filing of financial statements for all entities that are subject to annual statutory audit should be mandated by law.

- The limited liability company status of audit firms results in some audit firm individuals acting without due integrity. Therefore, the law should require audit firms to be established as limited liability partnerships, at a minimum, rather than limited liability company status.
- The three-year audit firm rotation requirements should be removed from the law. It should be replaced with the requirement for a rotation requirement for senior personnel (e.g., partner and manager).
- Compulsory insurance, which can mitigate possible risks regarding audit engagement, should be required for audit firms.

Recommendations for standard setting and enforcement

90. **Establish a sustainable accounting and auditing standard setting structure.** The standard setting structure should be established based on existing network and cooperation among MOF, MICPA, FRC, MNAO, BOM, and other relevant agencies. This framework would involve the following:

- Define a framework for effective working relations based on mutual support and cooperation to facilitate the process of setting standards and regulations. The Government should consider the mobilization of funding and technical expertise in order to ensure that the continuing development and issuance of SME standards are in line with IASB pronouncements.
- Banking, NBFI, and insurance regulators should be engaged in international forums exploring the relationship between prudential and general purpose financial statements in order to design prudential requirements.
- The proposed National Accounting and Auditing Standards Committee, with the support from MICPA, should update audit manual and methodologies for the audit practices when changes to or new ISA issuance are made. This would allow the audit profession of Mongolia as a whole to improve the quality of the audit, which would in turn lead to an increase in public confidence in the reliability of the information contained in financial statements.
- The existing translation process should be enhanced in order to achieve a sustainable translation process into the Mongolian language whereby the official translations of IFRS and ISA are readily available and affordable across the country.
- The Government should allocate sufficient recurring budget to carry out standard setting responsibilities in a timely manner. Budgets are required for translation of IFRS and ISA into Mongolian language, development of national SME standards, and reference guides on these standards.
- Regarding implementation of full IFRS in public interest entities, arrangements should be made for developing a time-bound strategy. Full implementation of international standards can not be made within a short period of time, and without putting in place appropriate institutional underpinnings of a robust financial reporting system.

91. **Improve systematic, institutionalized, and monitoring and enforcement mechanisms to ensure compliance with accounting standards.** High-quality financial

reporting depends on designing and implementing a proper monitoring and enforcement system. There are some crucial aspects in the monitoring and enforcement process, and each must be strengthened:

- Enforcement system should be designed for effective implementation of standards and not limited to enforcement actions. Enforcement system should be backed by laws and consider all relevant aspects with integration.
- A clear strategy should be developed for enhancing public knowledge of financial reporting standards.
- Both self-regulatory organizations and statutory regulators must ensure proper compliance with the standards and consistently take action against violators. To ensure effective enforcement, the regulators in particular need adequate capacity, authority, and independence. Since they cover a wide range of sophisticated and complicated activities, their actions should not be constrained by the lack of appropriate human and financial resources. Strengthening the enforcement mechanism through increasing capacity of the regulators and granting them more authority in dealing with infractions of accounting and auditing standards is particularly important for Mongolia to supplement Government efforts to promote investment and to consolidate a sound financial sector. Also, there is a clear need for updating legislation to outline the authority of regulatory bodies to enforce accounting and auditing standards and to modernize the existing sanctions in order to make them better deterrents.
- The supervisory agencies should increase its human resources by employing more staff who are familiar with IFRS. Also, on-going practical training on implementation of IFRS and ISA should be provided to staff.
- In order to supplement capacities of banking, micro-financing, and insurance regulators in particular to detect infractions, auditors should be prepared to play whistleblower in order to provide early signals for initiating necessary corrective measures by the regulators. Since the financial sector's vulnerabilities can have quick multiplier effects, appropriate whistleblowing by auditors would help to make the financial sector regulation more efficient and effective. Whistleblowing should focus on issues that may limit the case for producing transparent and reliable financial information and thereby mislead the users of financial statements.
- The analytical and monitoring MSE capacity and its process of disclosing information received from listed companies should be strengthened in order to provide timely and accurate information to the public. The FRC should ensure that information disclosed on the MSE website is accurate and timely and all noncompliance situations should be reported to FRC for investigation.

92. **Establish adequate, institutionalized audit oversight framework to ensure compliance with auditing standards.** A self-regulated professional body under Government oversight supervision should be established to oversee the audit quality within the country. The Government should monitor the overall effectiveness and appropriateness of the audit quality control system, including supervision of MICPA activities with respect to the review of audit firms. The Government should assign this oversight role to competent authority within its structure. As an oversight body in main

public interest areas, the FRC might be a potential supervising authority. Main activities of audit oversight would include the following:

- Adequate authority and capacity is necessary for effective monitoring. The Government should evaluate what types of authority are provided to self-regulatory agencies such as MICPA.
- Copies of reports resulting from reviews conducted by MICPA should be filed with the competent government authority (i.e., FRC) for review and final decisions on actions to be taken.
- An audit quality assurance unit should be established within a competent government authority (i.e., FRC) in order to supervise the overall audit quality including MICPA activities. This unit should obtain reports from MICPA summarizing the deficiencies and improvements noted in the audit quality assurance system of all audit firms. Such reports should be used to monitor the status of the overall quality of the audit firms.
- Mongolia should establish an effective enforcement system, including investigation and sanctions to prevent inadequate execution of the statutory audit. However, it should not be confused with civil or criminal sanctions and should focus on ensuring that all required information is both materially correct and available to the market so as to promote capital market efficiency. The MICPA-recommended enforcement actions should be discussed and approved by competent government authority (i.e., FRC). Also measures taken on sanctions imposed on statutory auditors and audit firms should be appropriately disclosed to the public.
- In parallel with above oversight mechanism, stakeholder oversight is needed. The Company Law should be amended to give more power and responsibility to the “supervisory council” under the shareholder’s meeting of listed company in order to protect minority shareholder’s interest by reviewing the financial position of the company, appointing the auditors, and conducting the supervision. The council members should be increased to at least three members with at least one proposed by minority shareholders.

Recommendations for development of the accounting and auditing profession

93. **Strengthen MICPA by establishing twinning arrangements with a developed professional accountancy body.** Through a long-term twinning arrangement, good practice could be transferred to MICPA. Without this type of arrangement and external expertise, MICPA would have difficulties to improve its capacity. Also, the MICPA governance structure should be restructured and its capacity strengthened in-line with international good practice. Also, necessary actions should be taken to fully comply with the 7 IFAC Statements of Membership Obligation.

94. **Strengthen the capacity of Mongolia National Audit Office.** The auditors of MNAO should receive adequate training on practical implementation of IFRS, IAS, and IFAC pronouncements on public sector accounting through continued professional training by MICPA, as well as through its own training programs. The auditors should have adequate expertise and advisory skills on financial reporting in order to provide

sufficient recommendations on improvement of accounting and financial reporting for state-owned enterprises and the various governmental agencies.

95. **Strengthen the capacity of audit firms to improve audit quality.** There should be an initiative for assisting audit firms to improve audit quality and assurance services.

96. **The MICPA should establish better public access to information on statutory auditors and audit firms.** This could include registration of certified public accountants, auditors, and audit firms; quality assurance reports; and list of sanctions taken against noncompliance. Availability of information in foreign language would greatly increase its usefulness especially in the context of foreign investments.

97. **Issue practical application guidance on IFRS and ISA.** The practical implementation guidance on IFRS and ISA, which could illustrate local cases, should be issued by the proposed National Accounting and Auditing Standards Committee and disseminated to the public in support from MOF and MICPA. The MICPA should ensure that all standards, interpretations, and implementation guidance are promptly available to its members.

98. **Enhance CPA examination, professional education, and training.** This plan would require focus on the following:

- The existing CPA examination program should be enhanced through restructuring its content and subjects based on international good practice. In this regards, the sequential approach to the qualification of CPA program should be adopted instead of the present 3-staged approach.
- It is necessary to revisit the present practical experience requirements and to bring them in line with IFAC requirements. Mentorship and supervision should be promoted.

99. **Upgrade the procedures for providing audit license in public practice.** Mongolia should streamline its licensing procedure by improving working relations among relevant bodies. Issuing authority should be shifted to competent authority (i.e., FRC) that oversees the audit quality. Also as bodies of audit quality oversight, the MICPA and FRC should develop a sound mechanism for periodic performance evaluation of the auditors.

100. **Introduce public awareness program for improving the degree of compliance with IFRS requirements.** The proposed National Accounting and Auditing Standards Committee, MOF, MICPA and other regulators should work jointly to design awareness programs highlighting the significance of compliance with accounting and auditing standards and to improve information dissemination channels. Shareholders, directors, and top officials from the corporate sector should be briefed adequately on their responsibilities to ensure compliance with standards and enforcement process, including legal implications. Benefits of compliance with standards and good practice should be highlighted in such programs. In addition, this program should include cases focusing on

emerging international development and the role of transparent financial reporting in attracting both strategic and portfolio investors.

101. **Improve professional ethics among professional accountants and auditors.** The MICPA Code of Ethics should be improved in line with international development that considers protection of public interest, enhances professional disciplines, and promotes professional obligation. For ensuring ethical standards and independence of practicing auditors in line with code of ethics, the MICPA should issue detailed guidance using local examples within the Mongolian environment.

102. **Obtain IFAC full membership.** The MICPA should start the process of obtaining IFAC full membership. Gaining IFAC membership would facilitate creating a better enforcement and compliance culture with regards to accounting and auditing practices in Mongolia. Also this would help Mongolia to improve the professional accounting education and training.

Recommendations for professional education and training

103. **Enhance academic education and training.** This plan would require focusing on the following:

- **Regulators.** The Government should assign the oversight role of accounting and auditing education to the competent government authority (or expanding NACHE or CES role) in order to ensure that the educational standards are maintained in teaching accounting and auditing courses in all Mongolia universities and colleges. This authority should have legal power to oversee and take actions on the noncompliance of educational standards.
- **University curriculum.** Further development of university curricula should include more emphasis on practical aspects of IFRS and ISA, and organizational and business knowledge components. Also, university curricula should include business ethics, management, and strategic decision-making. The curricula should be updated with new issuances and changes to IFRS and ISA. Universities should work with professional bodies to develop degree programs appropriate to the developmental needs of the business community.
- **Train-the-trainers program.** The capacity of higher educational institutions for teaching accounting and auditing courses should be enhanced with international components. This program could be focused on strengthening the teaching capacity and methodology of IFRS and ISA, and English communication skills of various universities and colleges in order to equally strengthen their capacity. Trained teachers could serve on the proposed National Accounting and Auditing Standards Committee or other professional bodies as freelance consultants in development of national standards and guidance on accounting and auditing.
- **Update of library.** It is important to update the library of universities and colleges in order to give access for obtaining up-to-date modern international books to students as well as teachers. The universities should allocate sufficient budget to purchase current textbooks.

104. **Ensure effective continuing professional education and development of accountant and auditors in public practice.** The requirements on continuing professional education and its realization should be improved in line with the IFAC-issued continuing professional education and development standards. The MICPA should improve delivery of training programs through facilitating access to programs offered by universities, and develop sound mechanisms for monitoring and enforcing requirements on continuing professional education of its members.

105. **Strengthen capacity of the tax inspectors.** Take necessary steps to strengthen capacity of tax inspectors to ensure that they have sufficient knowledge on IFRS.

106. **Mongolia should establish a mechanism to educate accountants and auditors to improve practical application on modern accounting and auditing.** Leveraging the practical experience calls for adoption of incentives to give opportunity to improve understanding and application of IFRS and ISA. A private sector accountancy education center should be encouraged and opened in Mongolia through specific measures. However, this center should be tailored to the needs of Mongolian companies. The core concepts, such as accrual basis, the separation of tax and financial reporting, interaction of financial statements, management accounting should be central to professional education.

Annex A. Mongolian Laws Related to Accounting and Auditing

<i>Law objective</i>	<i>Para. reference in ROSC A&A</i>
Company Law. Regulates the establishment, registration, and reorganization of a company; its management and organizational structure; the rights and obligations of its shareholders; and its control and liquidation.	9, 11, 20, 21, 79, 87, 92
Law on Partnership. Regulates the establishment, registration, management, organization, and control mechanism of partnership and related matters pertaining to financial reporting, restructuring and abolishment.	9, 14
Banking Law. Regulates matters concerning licensing of banks, the revocation of licenses, the establishment of general principles of a bank's management, organization and activities, and taking enforcement measures to a bank.	13, 16, 21, 87
Law on Non-Banking Financial Operations. Regulates the establishment of legal basis for non-banking financial operations, general principles of a non-banking financial institution's management, organization and control mechanism, and relations concerning licensing of non-banking financial institution, the suspension and revocation of license.	13, 16, 69, 87
Law on Cooperatives. Regulates the establishment of legal basis for cooperative and relations concerning the establishment, registration, abolishment, membership and control mechanism of cooperative, and enforcement measures to the cooperatives.	14, 21, 28, Table 2
Accounting Law. Regulates the determination of the legal ground for accounting principles, management, and institution; the relationship pertaining to the maintenance of accounting records and the preparation of financial statements of all entities and organizations.	12, 15, 18, 19, 20, 23, 54, 62, 87, 88
State Audit Law. Regulates the establishment of the legal basis for state audit system, structure and activities of organizations that conduct audits, and the process of auditing.	21, 27, 60
Corporate Tax Law. Regulates the matters arising from imposition of tax on entity and organization income, and transference of it to the state budget.	14
Law on Non-Governmental Organizations. Regulates relations concerning the association of citizens and the establishment and activities of nongovernmental organizations for the aim to implement the human rights.	14
Securities Law. Regulates the issuance of securities for the purpose of accumulating capital, the buying and selling of securities, depository arrangements and clearing and settlement services, the regulation of issuers and other persons involved in the securities market and the protection of investors.	6, 15
Law on Insurance. Regulates the establishment of the legal foundation for conducting insurance activities in the territory of Mongolia, interrelations between insurance companies, citizens and legal entities, and creation of principles for State auditing of insurance activities.	18, 21
Law on Auditing. Regulates and sets forth legal basis for auditing principles and organization, licensing of certified public accountants, and organization in auditing, supervision, acceptance of their full right, and its implementation.	21, 22, 24, 26, 27, 28, 29, 32, 34, 40, 54, 60, 61, 87, 88, 89
Law on Financial Regulatory Commission. Regulates the establishment of the legal grounds for the power of the Financial Regulatory Commission; its management, organization, and activities; and relations concerning the regulation, monitoring, and supervision of non-banking financial activities.	31, 87
Civil Code. Regulates relationship with respect to material and non-material wealth arising among legal persons.	9