



THE WORLD BANK

Public Disclosure Authorized

# ROSC

## Report on the Observance of Standards and Codes (ROSC)

CORPORATE GOVERNANCE  
COUNTRY ASSESSMENT

Mongolia

June 2009

Public Disclosure Authorized

# About the ROSC

## Overview of the Corporate Governance ROSC Program

### What is corporate governance?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The OECD Principles of Corporate Governance provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the board.

### Why is corporate governance important?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research. Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

### The corporate governance ROSC assessments

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank

and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment benchmarks a country's legal and regulatory framework, practices and compliance of listed firms, and enforcement capacity vis-à-vis the OECD Principles.

- The assessments are standardized and systematic, and include policy recommendations and a model country action plan. In response, many countries have initiated legal, regulatory, and institutional corporate governance reforms.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the World Bank can also carry-out special policy reviews that focus on specific sectors, in particular for banks and state-owned enterprises.
- Assessments can be updated to measure progress over time.
- Country participation in the assessment process, and the publication of the final report, are voluntary.

By the end of June 2009, 66 assessments had been completed in 55 countries around the world.



THE WORLD BANK

ROSC

## Contents

Executive summary .....	3
I. Landscape .....	4
II. Key findings .....	6
1. The corporate governance framework...	6
2. Shareholder rights .....	9
3. Treating shareholders equitably .....	12
4. The role of stakeholders .....	14
5. Disclosure and transparency .....	16
6. Board responsibilities .....	20
III. Summary table and figures .....	23
IV. Recommendations and action plan.....	24
Annexes .....	25

# Acknowledgements

This Corporate Governance ROSC report reflects technical discussions with a number of private and public sector institutions, as well as other relevant stakeholders, whom the World Bank would like to thank for their time and invaluable insight into corporate governance practice in Mongolia.

The World Bank would like to expressly thank the Parliamentary Standing Committee on Economic Policy; Financial Regulatory Committee; Ministry of Finance, in particular its Accounting and Supervision Department; Mongolia Stock Exchange; Bank of Mongolia; State Registration Agency; State Property Committee; Mongolian National Chamber of Commerce; Association of auditors; and Mongolian Institute of Certified Public Accountants; the Asian Development Bank; USAID - EPRC Corporate Governance Project; in addition to a number of companies, banks, and financial institutions, as well as law and audit firms.

This Corporate Governance ROSC was carried-out by Sebastian Molineus, Senior Operations Officer, with the support of Alexander Berg, Program Manager, and Johana Shah, Program Assistant, all with the World Bank's Corporate Governance Group. Arshad M. Sayed, Country Manager, Ochir Lkhagvasuren Portfolio Operations Officer, and Yadmaa Otgonbayar, all with the World Bank's Mongolia Office, provided invaluable support and inputs to the Corporate Governance ROSC. Sameer Goyal, Sr. Financial Sector Specialist, East Asia Financial and Private Sector Development Department; David I, Sr. Financial Management Specialist, East Asia Financial Management Unit; Shiilegmaa Altantsetseg, Economist, East Asia Poverty Reduction and Economic Management Sector Department; David Lawrence, Senior Operations Officer, IFC; Sergii Tryputen, Program Manager, IFC Corporate Governance Project for China and Mongolia; Eugene Spiro, Sr. Projects Officer, and Jose Cruz-Ozorio, Consultant, both with the IFC Global Corporate Governance Department; and Dr. Demir Yener, USAID - EPRC Corporate Governance Project peer reviewed and helped shape the final report through their thoughtful and insightful comments.

Much of the legal and regulatory analysis of this Corporate Governance ROSC is based on an in-depth review of the legal and regulatory framework conducted by the law firm Bona Lex LLC.



## Report on the Observance of Standards and Codes (ROSC)

### EXECUTIVE SUMMARY

Much has been achieved by the Mongolian government to improve the legal and regulatory framework for corporate governance. The Financial Regulatory Commission (FRC) approved the Mongolia Corporate Governance Code for publicly listed companies (MCGC) in 2007, the Bank of Mongolia (BoM) launched a set of corporate governance regulations for banks, and a number of amendments were made to modernize the company law, with further amendments planned for the securities law.

There is, however, a significant discrepancy between the “law on the books” and corporate governance practice as carried-out by Mongolian publicly listed companies. In summary:

- Many boards do not guide or supervise management, but instead manage the company on a day-to-day basis. Key policies on risk management, internal control and audit processes, disclosure, and succession planning are absent. Board nomination processes remain opaque and are dominated by majority owners, leading to boards composed of insiders and important skill-gaps.
- Financial reporting remains underdeveloped. A FRC survey in 2007 shows that only 36 percent (138 out of 380) companies submitted their financial statements in 2007. The 2008 World Bank Accounting and Auditing ROSC also found important deficiencies in compliance with International Financial Reporting Standards (IFRS). Non-financial disclosure, too, remains underdeveloped, and few companies disclose their ownership and governance structures.
- Basic shareholder rights are often not respected. For example, the FRC survey demonstrated that only 158 of the 384 listed companies conducted an annual general meeting of shareholders in 2007.

With this in mind, Mongolia’s policy-makers should guide and at times require companies to improve their corporate governance. More specifically, the government of Mongolia should:

1. *Hold all regulatory bodies accountable for enforcing the legal and regulatory framework.* The government should provide the BoM, FRC, Mongolia Stock Exchange (MSE), and other regulatory bodies with the necessary resources and ensure for their independence so that they may rigorously, consistently, and fairly enforce laws and regulations. There should be clear roles, reporting structures, and lines of responsibility between all enforcement bodies, and these should be made to cooperate in practice and held accountable.
2. *Restore trust in the market* by developing a de-listing process for all companies that are inactive, suspended, and/or fail to comply with laws and regulations, in particular MSE listing rules. The authorities should consider requiring companies that either wish or are required to delist to make a buy-out offer to minority shareholders. Shares should be valued independently and fairly.
3. *Modernize the corporate governance framework* by amending the company, banking, accounting and auditing, and securities laws, relevant regulations, in particular the listing rules, and the MCGC.
4. *Develop a strategy to improve upon the corporate governance of Mongolia’s state-owned enterprises.*
5. *Build a qualified cadre of directors* by supporting the Mongolia Corporate Governance Center and other nascent corporate governance institutions in developing quality director training programs, encouraging directors and managers to participate in such programs, and publicly raising awareness of and building the business case for good corporate governance. In the end, a sound understanding of what constitutes good corporate governance and why it matters is a prerequisite for ensuring that legal, regulatory, and institutional reforms are properly implemented—in substance and not only in form.

**📌 Introduction**

Target audience, assessment methodology and purpose of this CG ROSC

This Corporate Governance ROSC Assessment (CG ROSC) benchmarks Mongolia's legal and regulatory framework, practices, and enforcement framework against the OECD Principles of Corporate Governance (OECD Principles), the international reference point for good corporate governance. The OECD Principles and by extension this CG ROSC focuses on publicly traded companies, both financial and non-financial, but are equally applicable to other public interest entities, such as large, non-listed joint stock companies and state-owned enterprises (SOEs).<sup>1</sup> This CG ROSC is based on a diagnostic template of over 700 data points developed by the World Bank. The data is complemented by qualitative findings made during a series of meetings with key stakeholders in Mongolia.

This CG ROSC was commissioned by the Economic Policy Committee of the Mongolian Parliament. The primary target audience of this CG ROSC is the government of Mongolia and those responsible for setting corporate governance policy. Other stakeholders, in particular investors and companies themselves, can benefit from this report as well in terms of assessing and implementing good corporate governance.

**📌 The economic context**

Consistent growth has failed to reach the broad population and is dampened in the wake of the global crisis

Mongolia has achieved remarkable success in transitioning to a market-based economy and made great strides in implementing structural reforms and attaining macroeconomic stability. Gross domestic product (GDP) has risen steadily since 2002 at an approximate rate of 7.5 percent per year, rising to 10.2 percent in 2007, before falling back to a respectable 8.9 percent (est.) in 2008. Despite these growth rates, which are strongly correlated with world commodity prices, the proportion of the population below the poverty line has remained steady, hovering between 32 to 36 percent since 1998. GDP per capita was US\$ 1,981 in 2008, compared to US\$ 11,807 in Russia and US\$ 3,315 in China, its two neighboring countries. The global food and financial crisis, too, have had an important impact on all aspects of the Mongolian economy, with headline inflation rising to 34.1 percent in August 2008 (though it has since fallen to 12.6 percent as of April 2009) and the market spiking from 2,057 points in January 2007 to 13,519 in September 2007 and falling back down to 4,740 in June of 2009. Real GDP contracted by 4.2 percent year-on-year in the first quarter of 2009 and the GDP forecast for 2009 is 2.7 percent.

**📌 Company structures and the legal framework**

A limited number of listed companies regulated by an appropriate, if slightly outdated, legal framework

There are approximately 50,000 independent businesses in Mongolia, of which 37,000 are thought to be active. Mongolian company law (CL) allows for general and limited partnerships, cooperatives, limited liability companies, and joint stock companies. In December of 2007, there were 384 joint stock companies listed on the Mongolian Stock Exchange (MSE). There are 16 commercial banks and 137 non-bank financial institutions (NBFIs) operating in Mongolia.

The legal and regulatory framework for corporate governance is relatively advanced and in-line with Mongolia's current state of economic development. Most basic laws relevant for corporate governance—the CL, securities market law (SML), accounting law (AL) and auditing (LoA), banking and non-bank financial institutions laws (BL and (NBFIL), and specialized regulations, including listing rules—are in place and contain many good practice provisions. Though the overall framework is largely based on the rule of law and has served to help Mongolia transition to a market based economy and generally support growth, there has been some justified criticism that the legal and regulatory framework is outdated and that specific provisions contradict one another.

**📌 Capital markets**

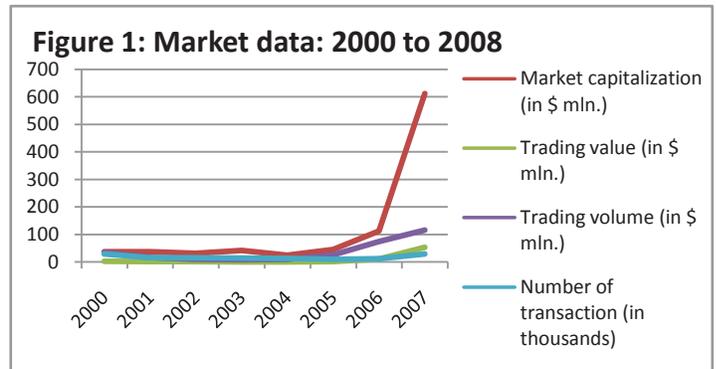
Capital markets are underdeveloped

The Mongolian capital markets remain underdeveloped. Market capitalization, trading volume and value, and liquidity are relatively low. Since 2000, the MSE has averaged five new listings and nine de-listings per year. Although the stock market capitalization has grown (see Figure 1), a few shares account for nearly all of the market capitalization and active trading. Similarly, trading is thought to be concentrated in the MSE-20 Index of the largest Mongolian companies. A great number of companies originally listed as part of the

<sup>1</sup> Unless otherwise designated, all references to "companies" in this CG ROSC report shall mean Mongolian companies that are listed and traded on the MSE.

privatization program of the early 1990s are little more than shells today.<sup>2</sup> Of note is that the Financial Regulatory Commission (FRC) de-listed 200 of the 384 listed companies in November 2007 in order to aid the development of a robust capital market, and to support the reputation of the MSE, however, subsequently reversed its decision.

Of the companies listed on the MSE, 21 or 5.5 percent are fully state-owned, 35 or 9.1 percent partly owned by the state, and the remaining 328 or 85.4 percent fully in private hands. However, of the 2.5 billion shares listed on MSE, 1.9 billion or 74.5 percent were owned by the



state and 636 million shares or 25.5% owned by private individuals.<sup>3</sup> Indeed, most privately-owned companies are considered relatively small. Market participants estimate that the ownership structure of those companies that are majority privately owned is highly concentrated, with approximately 70 percent of common shares held by one to three individuals. The corporate governance framework and practices of SOEs is considered to be underdeveloped by most market participants, in particular with respect to board practices, disclosure, and control frameworks. The banking sector is significantly foreign-owned and bank governance is thought to be advanced in comparison to companies and SOEs, however, still lags behind international good practice. Domestic institutional investors, such as the government pension fund, are not thought to play a role in investing in Mongolian equities. Minority shareholders are for the most part current and former employees who received shares as part of the mass privatization program of the 1990s, and most are unfamiliar with their rights as shareholders, with some shareholders even oblivious of the fact that they are shareholders.

The principal enforcement institutions in Mongolia relevant for corporate governance are the Ministry of Finance (MoF), which is responsible for, *inter alia*, enforcing accounting and auditing standards, the FRC, which enforces the SML and relevant regulations, Bank of Mongolia (BoM), which in turn enforces the BL and specific banking regulations, MSE, responsible for generally organizing the market and enforcing its listing rules, the Securities Clearing House & Central Depository Co. Ltd (MSCH&CD), which clears and settles trades, and serves as the central depository, and, finally, the Mongolian Institute of Certified Public Accountants (MICPA), a self-regulatory, non-governmental organization which helps develop and update accounting and auditing standards.

Finally, Mongolian authorities have expressed great interest in and have shown some commitment to improving corporate governance. For example, the OECD Principles of Corporate Governance have been translated into Mongolian, a code of corporate governance was passed in 2007 and approved by the FRC, and the BoM has passed a regulation on bank governance. Moreover, a series of events were held to raise awareness of corporate governance in general and the Mongolia Corporate Governance Code (MCGC) in particular. Finally, the Mongolia Corporate Governance Forum and Corporate Governance Institute were recently established, with a view towards improving upon corporate governance in Mongolia. However, most of these initiatives were launched and led by international or bilateral donor agencies.

### Ownership structures

Ownership remains concentrated in the hand of the state

### The institutional framework

The principal enforcement bodies exist

### Commitment to reforms

Commitment must be strengthened and ownership demonstrated

<sup>2</sup> The 2007 FRC report found that 62 companies were in financial and/or operational difficulties, and 146 to be insolvent; 67 percent of these insolvent companies' capital was thought to have been misused.

<sup>3</sup> MSE 2007 Factbook. See [www.mse.mn/](http://www.mse.mn/)

# CHAPTER I

## Ensuring for an Effective Corporate Governance Framework

### Gap analysis

**🔗 Principle I.A.:** The corporate governance framework should impact overall economic performance, market integrity and incentives, and transparent and efficient markets.  
**Status: Partially implemented**

**🔗 Principle I.B.:** The corporate governance laws and regulations should be consistent with the rule of law, transparent, and enforceable.  
**Status: Partially implemented**

Mongolia has partially implemented<sup>4</sup> Chapter I of the OECD Principles. Specifically:

***The operation of the capital market is not viewed as being reasonably transparent.*** The corporate governance framework does not ensure for high levels of financial and non-financial disclosure and transparency (see also Key Findings, Chapter V). Insider trading and market manipulation remain issues of concern for many market participants, and market intermediaries are not thought to operate in a transparent manner.

***Authorities do not develop policies, laws, and regulations on the basis of effective consultation with stakeholders.*** While some authorities place draft laws on the Parliament's website, and the FRC has a "project discussion" menu on its website and itself places drafts of its regulation online for public discussion, most governmental bodies fall short of good practice as they do not actively solicit comments, organize roundtable events to gather feedback and buy-in, and publish comments online.<sup>5</sup> For example, the MCGC was largely developed and drafted by the Asian Development Bank (ADB); and though the MCGC was approved by the FRC in 2007, only three public consultation workshops were held, targeting the FRC, financial intermediaries, and NGOs. Companies were not targeted to participate in the consultation process.

***The legal and regulatory framework is not sufficiently enforced, only partially understood, but reasonably foreseeable.*** Most laws and regulations are readily accessible and available online in both Mongolian and English. Mongolia's legal and regulatory framework is free from backdated amendments. On the other hand, many of the laws and regulations are not consistently enforced by the regulatory authorities, and several market participants cited that key laws and regulations, in particular in the area of accounting and auditing, were not well understood by companies or investors.

***The legal and regulatory framework is not used in an arbitrary or inconsistent manner incompatible with the rule of law, but too complex for some companies.*** While laws and regulations are not used in an arbitrary manner by the authorities, a number of laws are not enforceable as they are too complex to comply with by some Mongolian companies. Thus, unlisted joint stock companies that by most accounts would qualify as small and medium-sized enterprises (SMEs) are required to apply International Financial Reporting Standards (IFRS) in preparing their financial reports, against good practice. More generally, Mongolia ranks in the 44<sup>th</sup> percentile in terms of the rule of law according to the World Bank's Worldwide Governance Indicators Project.<sup>6</sup>

***The MCGC meets many good practice provisions, however, is not followed in practice.*** The MCGC was initially issued on a voluntary basis, targeting companies listed on the MSE. A 2007 FRC decree now states that the MCGC is to be implemented by companies on a "comply or explain" basis.<sup>7</sup> However, due to the lack of a comprehensive consultation process, many companies are unaware of the MCGC and compliance is consequently low. Similarly, the BoM issued a corporate governance regulation for banks in 2006 and the State Property Committee (SPC) is drafting a corporate governance regulation for SOEs.<sup>8</sup>

<sup>4</sup> See Section III, Summary Table, on page 24 for an explanation as to when individual OECD Principles have been "fully", "broadly", "partially", or "not" implemented, or are not applicable.

<sup>5</sup> The Mongolian government recently launched a project "open government" to become more transparent and inclusive. However, this project has since only resulted in a webpage, which is not always operational.

<sup>6</sup> See <http://info.worldbank.org/governance/wgi>. This "rule of law" indicator measures the extent to which agents have confidence in and abide by the rules of society, *inter alia* the quality of contract enforcement.

<sup>7</sup> FRC Resolution No. 210.

<sup>8</sup> BoM Regulation No. 594.

**Principle I.C.:** The division of responsibilities among enforcement bodies should be clearly articulated and ensure that the public interest is served.  
**Status: Partially implemented**

**Principle I.D.:** All enforcement bodies should have the authority, integrity, and resources to fulfill their duties professionally and objectively. Rulings should be timely, transparent, and explained.  
**Status: Partially implemented**

*The government of Mongolia has taken active steps to improve upon cooperation between enforcement bodies.* Mongolia has a series of specific laws and regulations, *inter alia*, for banks, NBFIs, SOEs, and companies, each of which designates a specific enforcement body, though the legal and enforcement framework for leasing appears underdeveloped. The regulatory framework calls for a tripartite memorandum of understanding (MoU) between the BoM, FRC and SPC to ensure for financial market stability,<sup>9</sup> and such MoU was signed between all three institutions in November 2006. Moreover, a Financial Stability Council (FSC) was established by joint decree dated May 2007 by the BoM, MoF, and FRC, to further help coordinate activities. The BoM and FRC are to conduct joint supervisions of listed banks or financial groups that pose a risk to financial market stability via a BoM-FRC Coordinating Unit, comprised of BoM, MoF, and FRC directors. However, cooperation between the enforcement bodies needs to be improved upon in practice.

*The FRC does not have the necessary authority and resources to be effective in its enforcement efforts.*<sup>10</sup> The FRC was only recently established in 2006 and, although as such still nascent, already enjoys a positive reputation among market participant. The FRC has a reporting line and is accountable to Parliament, in-line with good practice (Art. 9.1 and 10.5 FRC Law). Parliament also approves the FRC's budget—only half of which is derived from penalties and fees, with the other half coming from the state's budget—and the legal framework assures the FRC's operational independence, though some market participants have voiced their concerns of the FRC's independence vis-à-vis government pressures. The FRC publishes an annual report and summarizes its enforcement actions, however, does not publish specific information of which companies or financial intermediaries were sanctioned for legal or regulatory breaches. In the end, a great number of basic corporate governance practices and fundamental shareholder rights, such as conducting an annual meeting of shareholders (AGM) and receiving audited annual financial statements, are not complied with in practice and hence not properly enforced. Most market participants cite the absence of an effective regime of penalties and sanctions as a key reason as to why the FRC is unable to properly enforce laws and regulations vis-à-vis NBFIs; and with respect to companies, the FRC is unable to issue fine at all. The FRC appears under-staffed and under-funded to oversee the nearly 400 companies and 137 NBFIs; for example, the FRC only has three state inspectors.

*The BoM, similarly, enjoys a positive reputation as an effective regulator, though questions with respect to its enforcement of laws and regulations have arisen of late.* The 2008 IMF and World Bank assessment of the Basel Core Principles (BCPs) for Effective Banking Supervision found that banking supervision has improved markedly over the years and is now relatively well developed. The BoM is thought to have largely built the requisite expertise (though it, too, complains of losing senior staff to better paying jobs in the private sector) and put in place an appropriate supervisory framework for risk-based supervision.<sup>11</sup> The BoM also reports and is accountable to Parliament, in-line with good practice, and publishes an annual report although it too fails to publish specific information on which banks were sanctioned. Recent financial difficulties among banks, on the other hand, show that bank supervision can be improved upon, in particular with respect to bank-level operational risks and corporate governance issues.

*The MSE* has been operating since 1991. And although the average staff salaries are comparable with private and public sector institutions, including the BoM and FRC, it has been unable to attract, motivate, and retain senior staff. The MSE is not entirely uncontroversial among market participants and there has been talk of creating a rival,

<sup>9</sup> Art. 10 (1) FRC Law.

<sup>10</sup> Overall, the World Bank's Worldwide Governance Indicators Project ranked Mongolia in the 41<sup>st</sup> percentile in terms of regulatory quality. See <http://info.worldbank.org/governance/wgi>.

<sup>11</sup> IMF Country Report No. 08/300. Mongolia: Financial System Stability Assessment, Sept. 2008.

privately-owned stock exchange. Because the MSE remains 100 percent state-owned, its chairman is nominated by the SPC, though it formally reports to the FRC, thus creating an accountability gap. There have been ongoing discussions to privatize the MSE.

*The court system is considered to have improved over the past few years.* Mongolia is currently ranked a respectable 38<sup>th</sup> on the World Bank's Doing Business "enforcing contracts" indicator. On the other hand, some judges are not thought to have the know-how to judicate complex corporate disputes regarding CL and SML matters. Court proceedings can take anywhere from six to eighteen months, and are considered somewhat inefficient. Moreover, market participants have cited a number of instances in which suits involving high profile individuals and/or large sums have led to controversial ruling. The Mongolian Chamber of Commerce offers arbitration on commercial, corporate, and securities matters, which are binding and final.<sup>12</sup> Mongolia is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In practice, arbitration is used and an arbitral award obtained in a foreign (or domestic) arbitration proceeding will be enforced by the courts in Mongolia without re-examination or re-litigation.

To further close the gap between Mongolia's corporate governance framework and Chapter I of the OECD Principles, the Mongolian government may consider the following reforms:

#### Short-term priorities

- **All enforcement bodies, in particular the BoM, FRC, and MSE, should strengthen their enforcement actions** vis-à-vis banks, NBFIs, and companies to ensure for better compliance with relevant laws and regulations. To do so, their respective resources, supervisory processes, reporting lines, and independence should be re-evaluated to ensure that they are able to effectively carry-out their objectives. At the same time, parliament should hold the FRC and BoM accountable for enforcement actions.
- **The key public sector institutions, including the MoF, BoM, FRC, MSE, and others should help raise awareness of good corporate governance** by supporting nascent training organizations, organizing or participating in corporate governance events, issuing publication on corporate governance, and generally promoting the business case for good corporate governance in public.

#### Medium-term priorities

- **The FRC and MSE should strengthen the listing rules and de-list companies** that are not in compliance with the legal and regulatory framework.
- **All laws and regulations should be amended to capture changes made to international benchmarks in good corporate governance.** The relevant legislators and regulators should amend and modernize the existing legal and regulatory framework, actively solicit comments, organize roundtable events to explain new laws and provisions, gather feedback and buy-in, and disclose comments online. In particular the MCGC should undergo a revision and renewed public consultation effort to better raise awareness and secure buy-in from the public sector.
- **All regulatory and quasi-regulatory bodies should become more transparent,** in particular with respect to disclosing enforcement actions undertaken. The MSE should provide an example to companies by voluntarily following the MCGC.

A more detailed set of recommendations can be found in Part IV. of this report on "policy recommendations and country action plan".

<sup>12</sup> Art 40 (1) and 42 (1) Arbitration Law of 2003.

# CHAPTER II

## The Rights of Shareholders and Key Ownership Functions

### Gap analysis

**¶ Principle II.A:** The corporate governance framework should protect shareholders' rights.  
**Status:** Partially implemented

Mongolia has partially implemented Chapter II of the OECD Principles. Specifically:

*A number of basic shareholder rights are contained in the legal framework*, e.g. the ability to participate in the GMS and vote for directors, though these are not consistently complied with in practice. As Table 1 demonstrates, basic shareholder rights are provided for by law.

**Table 1: A legal review of basic shareholder rights according to Principle II.A.**

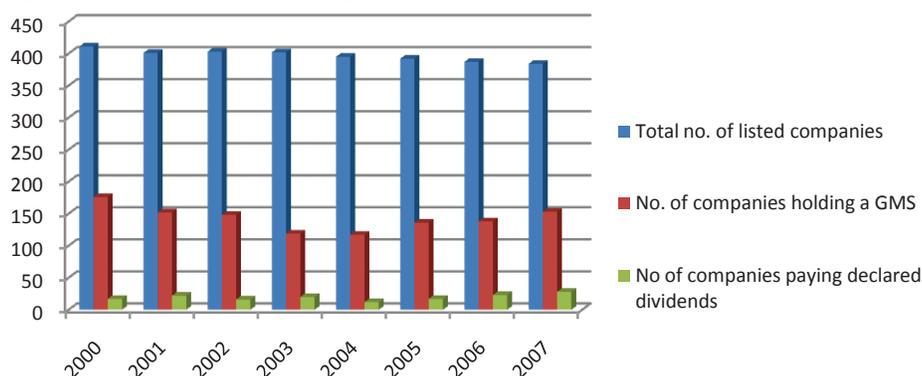
1. Secure methods of ownership registration	✓	Art. 46 CL: Companies are required to maintain a shareholders list and the MSCH&CD maintains a central register, both of which shareholders can inspect.
	✓	Art. 25.3 SML: The MSCH&CD is liable for failing to safeguard and ensure for the completeness of securities.
	✓	The MSCH&CD's transfer system is generally considered widespread and reliable.
2. Convey or transfer shares	✓	Art. 4.1 CL mandates the free transferability of shares. <sup>13</sup>
	✓	All listed securities on the MSE are dematerialized and deposited with MSCH&CD, which appears to be adequately funded, staffed, and independent. Settlement is conducted at full DVP, at T+1.
3. Information rights	✓	Art. 96 CL provides shareholders with rights to material information.
4. Participate and vote in the GSM	✓	35.1.1 CL: A holder of common shares shall have the right to participate and vote in the GMS. Procedural mechanisms do not permit companies to impede shareholders from participating and voting in the GMS.
5. Elect/remove board members	✓	Art. 63.1.7, 77.1, and 77.4 CL allow for shareholders to elect (and remove) directors via cumulative voting.
6. Share in profits of the corporation	☒	Art. 47.3 CL: Shareholders of the same class are treated equally vis-à-vis profits; however, the board and not shareholders approve dividends.

While most of these basic shareholder rights are anchored in law, not all companies are thought to adhere to these legal provisions. For example: (i) only seven percent of companies both declared and distributed dividends totaling MNT 7.4 billion (approximately US\$ 5.2 million) in 2007, and market participants state that some companies distribute dividends to their majority but not minority shareholders (to illustrate: of the 13 companies that distributed dividends through the MSCH&CD, 46,500 shareholders were entitled to receive MNT 6.3 billion, of which MNT 5.8 billion was ultimately distributed to 800 shareholders), and that brokers do not help distribute dividends to minorities in practice; (ii) between 2000 and 2007, well under half of companies failed to conduct a GMS (see Figure 2 below); and (iii) few companies disclose their financial statements to shareholders.<sup>14</sup>

<sup>13</sup> Art. 57.3 CL provides an exception: A majority GMS decision may block the sale of a controlling stake.

<sup>14</sup> FRC 2007 Annual Report.

Figure 2: Companies conducting a GMS and paying dividends



**Principle II.B:** Shareholders should have the right to participate in, and be sufficiently informed on, decisions concerning fundamental corporate changes.  
**Status: Partially implemented**

**Principle II.C:** Shareholders should have the opportunity to participate effectively and vote in the GSM.  
**Status: Partially implemented**

**Principle II.D:** Capital structures enabling shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.  
**Status: Partially implemented**

*Shareholders have the legal right to participate in, be sufficiently informed on, and approve decisions concerning fundamental corporate changes* such as: (i) amending the articles of association or similar governing documents (Art. 63.1.1 CL); (ii) conducting extraordinary transactions, including mergers (Art. 63.1 CL), as well as conflict of interest transactions (Art. 84.1, 89.4.2 CL); and (iii) waiving preemptive rights (Art. 39.6 CL). However, only extraordinary transactions with related parties require a two-thirds majority vote. Moreover, the board and not shareholders approves a rise in the company's authorized capital or issuance of new shares, unless stated otherwise in the articles of association (Art. 43.1, 76.1 CL), against good practice which calls for shareholder participation.<sup>15</sup>

*Companies are required to provide sufficient and timely information on the date, location, agenda, and issues to be decided at the GMS.* Companies are required to provide advance notice of 30 days before the date of the GMS,<sup>16</sup> deliver sufficient materials to shareholders, including the annual audited financial statements (Art. 66.4 CL) and background information on candidates to the board (66.4.4 CL). And shareholders holding at least ten percent of the company's shares are able to request the shareholders list, including the names, addresses, and number of shares held by other shareholders.

*Shareholders do not have a formal opportunity to ask the board questions at the GMS. They are, on the other hand, able to nominate directors and vote in absentia.* Shareholders holding five percent of the company's common shares may propose agenda items for discussion during the GMS, as well as propose candidates to the board 45 days before the GMS, in-line with good practice (Art. 67.1 CL). Shareholders may vote in person or by proxy with a formal power of authority, and may vote by mail during EGMs. Shareholders are not encouraged to ask the board questions, and board members in turn not required or encouraged to answer such questions.

*Shareholders are able to participate in key governance decisions*, in particular with respect to the remuneration of board members (Art. 66.5.14 CL), though it is not clear whether this only includes the remuneration of non-executive directors or is also thought to encompass executive compensation.

*The corporate governance framework does not require companies to publicly disclose their capital structures.* Shareholders holding ten percent or more of shares may demand that the company provides them with a list of the number of shares held by each shareholder (96.3 CL), and shareholders are required to inform the FRC when they, individually or

<sup>15</sup> If the board does not unanimously adopt the resolution to conclude a major transaction, including the issuance of new shares equal to or more than 25 percent of outstanding shares, then the resolution shall be submitted for shareholders approval (Art. 85.1 CL).

<sup>16</sup> Art. 3.2 Regulation on Giving Notice of a GMS of a Joint Stock Company.

jointly, own more than five percent (and ensuing increments of five percent) or one-third of the company. The FRC is in turn required to publicly disseminate information on owners holding five and more percent (MC-6-1, Appendix II of FRC Resolution No. 206), but does not appear to do so in practice. The MCGC encourages companies to disclose the names of shareholders that own five percent or more of the company (5.6 MCGC). Companies are not required or encouraged to disclose group structures, shareholder agreements, or special voting rights. In practice, ownership structures are thought to be opaque, and even the BoM and FRC are often unaware who the beneficial owners of a bank or company are.

**Principle II.E:** Markets for corporate control should be allowed to function in an efficient and transparent manner.

**Status:** Broadly implemented

*The Mongolian legal framework has fair and transparent procedures governing the acquisition of corporate control.* An individual (directly or with connected persons) purchasing five or more percent of a company—and each time the number of shares increases by five percent—is required to disclose this fact within ten business days (Art. 12 SML), however, to the FRC and not shareholders. The legal framework grants shareholders preemptive rights (Art. 59.1 CL) when shareholders, either individually or collectively, acquire one-third or more of the company and specifies that the price for these shares may not be less than the weighted average market price during the preceding six months; a two-thirds majority vote of attending shares is required to waive this right. Anti-takeover devices are not known to exist in Mongolia, and while the legal and regulatory framework does not provide for a specific duty of care and loyalty during changes of control, the law does call for the company’s directors and officers to act in good faith and in the company’s interests (Art. 81.2 CL). Finally, the legal framework does not effectively allow for a de-listing process for companies that are inactive, suspended, and/or fail to comply with laws and regulations, in particular MSE listing rules. In this same vein, the legal and regulatory framework neither foresees sell-out and squeeze-out rights to facilitate the de-listing of companies, nor accompanying mechanisms to ensure that minority shareholder rights are protected through fair and independent valuations of their equity stakes.<sup>17</sup>

**Principle II.F:** The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

**Status:** Not applicable

*The legal and regulatory framework is silent on the exercise of ownership rights by institutional shareholders.* Specifically, institutional investors are neither required nor encouraged to vote, or to disclose their voting policies and actual voting. The same holds true for their engagement with investee companies to help these improve their corporate governance. Finally, institutional investors are not required or encouraged to develop and disclose a policy for dealing with conflicts of interest. As previously mentioned, institutional investors do not play a role in Mongolia.

**Principle II.G:** Shareholders should be allowed to consult with each other on issues concerning their basic rights.

**Status:** Broadly implemented

*The corporate governance framework does not expressly allow or forbid shareholders to consult with each other.* The legal and regulatory framework is silent on this issue. However, the CL states that shareholders holding at least ten percent of a company’s shares are able to view the list of shareholders having the right to attend the GMS, which may be interpreted as allowing shareholders to coordinate with one another.

## Recommendations

**Short-term priorities**

To further close the gap between Mongolia’s corporate governance framework and Chapter II of the OECD Principles, the Mongolia government may consider the following reforms:

- **The CL should be amended** to, *inter alia*, require shareholders and not the board to approve dividends. The FRC should in turn ensure that brokers distribute dividends to minority shareholders, as required by law.

<sup>17</sup> The “squeeze-out” right is the right of a majority shareholder to compel minority shareholders to sell their shares to him, with appropriate safeguards to protect minority shareholders and ensure for a fair valuation of shares. The squeeze-out right is the mirror image of the “sell-out” right, which allows a minority shareholder to compel the majority shareholder to purchase his shares.

## CHAPTER III

## The Equitable Treatment of Shareholders

shares, based on a board decision; and (iii) require companies to publicly disclose the capital structures of company groups, shareholder agreements, and special voting rights.

## Gap analysis

**⚠ Principle III.A:** All shareholders of the same series of a class should be treated equally.  
**Status: Partially implemented**

**Mongolia has partially implemented Chapter III of the OECD Principles. More specifically:**

***The law ensures for equality, fairness, and disclosure of rights within and between share classes.*** The Mongolian legal framework goes beyond good practices as defined in the OECD Principles and calls for each share to have one vote, with the exception of cumulative voting (Art. 64.2 CL). On the other hand, proposals to change the voting rights of a different series and class of shares are not required to be submitted for shareholder approval and companies are not required or encouraged to disclose information about its classes and series of shares.

***Minority rights are somewhat protected from (potential) abuse by controlling shareholders.*** The corporate governance framework provides for:

- *Ex-ante* mechanisms to protect shareholders, in particular: (i) two-thirds majority shareholder votes to amend the company's articles of association, agree to a merger or acquisition, or approve conflict-of-interest transactions (Art. 64.5 CML); (ii) the ability for shareholders holding at least ten percent of the company's shares to call an EGM and call for an extraordinary audit (Art. 62.2 and 91.2 CL); and (iii) withdrawal rights for shareholders who voted against or did not participate in voting for a resolution adopted at a GMS with respect to reorganizations, extraordinary transactions, and amendments to the articles.
- *Ex-post* sanctions to protect minority shareholders, *inter alia*: (i) the ability of a shareholder holding one percent or more of the company's shares to file a derivative suit against the company's directors and officer for compensation of any loss caused to the company (Art. 83.1, 87.2, and 90.4 CL). Of note is that there is some legal uncertainty as to whether his provision refers to a single shareholder or a group of shareholders holding one percent. In practice, few shareholders are known to file suits against directors.

***The corporate governance framework is silent on whether beneficial owners are able to direct their custodian on how to vote, and whether custodians are required or encouraged to develop voting policies.*** Custodians do not play a role in Mongolia.

***There are no obstacles to cross border voting.*** The legal framework clearly specifies that foreigners are allowed to exercise their rights (Art. 12.2 CL) and the 30 day notice period and ability to vote by mail allows foreign investors to practically exercise their voting rights. Foreign investment is subject to additional regulations in strategic sectors, notably petroleum and mineral deposits extraction. In practice, foreign investors report some abuses of inspections and licensing processes.

***The equitable treatment of shareholders at the GMS is ensured for.*** Companies are required to facilitate voting by conducting the GMS at a location where the majority of shareholders are concentrated and the least amount of expenditures are required for shareholders to participate (Art. 3.15 CL). Companies also must conduct voting by ballot and shareholders may approve the use of an independent tabulation commission to count votes (Art. 681. And 68.2 CL). Finally, companies are required to either announce the

**🔑 Principle III.B:** Insider trading and abusive self-dealing should be prohibited.  
**Status: Partially implemented**

**🔑 Principle III.C:** Directors and key executives should be required to disclose to the board whether they have a material interest in any transaction.  
**Status: Partially implemented**

voting results during the GMS or in a separate report to shareholders (Art. 74.4 CL).

***The legal framework prohibits insider trading, though enforcement action is insufficient.*** Improper insider trading and market manipulation is prohibited by law (Art. 17.2 SML) and the definition of “insider trading” and “insiders” is sufficiently broad (Art. 3.15, 17.1 SML) to capture most cases of insider dealing. Insiders who misappropriate or embezzle a company’s assets, or abuse their office, are subject to a fine or imprisonment for a term of up to ten years, and are also generally barred from serving as directors and officers (Art. 150 and 265 Criminal Code). On the other hand, there are no closed periods during which directors and officers are barred from trading in their company’s securities and for this information to be made publicly available in a timely manner to shareholders and the markets. And while the MSE is in a position to continuously collect and analyze trading data to better detect insider trading, few actions have been taken to date against insiders, although a number of market participants cited insider trading as an ongoing issue.

***Conflict of interest and related party transactions are sufficiently regulated in the legal framework, however, thought to be an issue in practice and not properly enforced by the regulatory authorities.*** Directors and key executives are required to disclose to the board and external auditor their material interests affecting the company (Art. 88.1.3 CL). Moreover, related parties are properly defined in both the CL (Art. 86.1 CL) and AL (IAS 24.1). Of note is that the board is required to review and approve conflict-of-interest transactions (Art. 76.1.17 CL), that conflicted directors may not vote when conflicted (Art. 76.2, 79.5 CL), and that such transactions are subject to GMS approval when, *inter alia*, its value exceeds two percent of the company’s assets (Art. 89.4 CL). Financial reporting requirements further call for the full disclosure of related party transactions (IAS 24.1). However, while the legal and regulatory framework largely follows good practice, almost all market participants cited abusive related party transactions as a major issue used by company insiders to misappropriate company assets for personal gains. The above-mentioned FRC report confirms such abuses. Regulatory authorities appear to have been unable to enforce existing laws and penalize those who conduct abusive related party transactions.

## Recommendations

**🔑 Short-term priorities**

**🔑 Medium-term priorities**

To further close the gap between Mongolia’s corporate governance framework and Chapter III of the OECD Principles, the Mongolia government may consider the following reforms:

- ***There should be closed periods during which directors and officers are barred from trading*** in their company’s securities; directors’ trading in company securities should be made publicly available to shareholders and other stakeholders in a timely manner.
- ***The FRC should rigorously enforce relevant laws and regulations*** to better prevent related party transactions and insider trading.
- ***The CL should be amended*** to require that, *inter alia* (i): proposals to change the voting rights of a different series and class of shares are to be submitted for shareholder approval; and (ii) companies are to publicly disclose information about its classes and series of shares.

A more detailed set of recommendations can be found in Part IV. of this report on policy recommendations and country action plan.

# CHAPTER IV

## The Role of Stakeholders in Corporate Governance

### Gap-analysis:

**🔗 Principle IV.A:** The rights of stakeholders that are established by law or through mutual agreements are to be respected.  
**Status: Partially implemented**

**🔗 Principle IV.B:** Where stakeholder interests are legally protected, stakeholders should have effective redress for violation of their rights.  
**Status: Broadly implemented**

**🔗 Principle IV.C:** Performance-enhancing mechanisms for employee participation should be permitted.  
**Status: Partially implemented**

**🔗 Principle IV.D:** When legally relevant, stakeholders should have access to relevant, sufficient, reliable, and timely information.  
**Status: Not implemented**

**🔗 Principle IV.E:** Stakeholders should be able to freely communicate illegal practices and should not be compromised for doing so.  
**Status: Not implemented**

**Mongolia has partially implemented Chapter IV of the OECD Principles. More specifically:**

*The corporate governance framework provides for the enforcement of established legal rights for stakeholders.* For example, (i) *employees* have the right to minimum health, safety, and sanitary conditions (83.1 LC), assemble with other employees (Art. 6.1 LC), and be treated equally (Art. 7.2 LC); (ii) *creditors*, too, enjoy specific rights, for example, the right to request that courts reverse transactions conducted under market value that rendered the company insolvent (Art. 49 CL); and (iii) the *environment* enjoys some legal protection, with companies being required to conduct environmental impact assessments (Art. 3 EPL) and being liable to compensate individuals for damage to their property or health resulting from adverse environmental impacts stemming from their activities (Art. 4 EPL). In practice, many companies are not thought to respect these stakeholder rights.

*The corporate governance framework includes enforcement and remedial mechanisms to protect stakeholder rights.* Individual and collective labor disputes between employers and employees may be resolved by the Labor Dispute Settlement Commission (Art. 116, 125 LC) or courts (Art. 12 CPC). The legal framework also holds that a company as a legal person is generally liable for violating the rights of its stakeholders, and that the company's directors and officers may be held personally liable if they have caused damages to the company due to their wrongdoing (Art. 82.1 CL). Mongolia ranks a respectable 38<sup>th</sup> on the World Bank's Doing Business "enforcing contracts" indicator, though a number of issues to increase court efficiency remain.

*The corporate governance framework permits performance enhancing mechanisms for its employees.* The legal and regulatory framework is silent on performance enhancing mechanisms for its employees—in particular employee share and share option programs—although the law does mention that companies may, in addition to the basic salary, remunerate its employee based on work performance (Art. 50 LC), and offer executives bonuses.

Company-based pension funds are not overseen by independent trustees tasked to manage the fund for all beneficiaries.

*Most stakeholder groups are not generally provided with (reliable and timely) information to facilitate their participation in the governance process.* The legal or regulatory framework does not in fact accord employees a right to participate in the governance process, for example, through board representation or the establishment of employee councils. The same holds true for creditors, who do not have the right to participate in the governance process, for example, through an annual debtholders meeting, which a number of other jurisdictions accord to this important stakeholder group. The legal framework on the other hand requires creditors to be provided with information during insolvency proceedings.

*The legal and regulatory framework does not require or encourage companies do adopt whistle-blowing policies* that encourage its employees to report corporate wrongdoings, i.e. illegal or unethical behavior. The legal and regulatory framework further does not protect whistle-blowers from potential reprisals from insiders.

**¶ Principle IV.F:** The corporate governance framework should be complemented by an efficient insolvency framework and effective enforcement of creditor rights.  
**Status: Partially implemented**

### Recommendations

#### ¶ Short-term priorities

*The insolvency system does not involve excessive delays, however, when assessed against international standards applicable to insolvency, the Mongolian Bankruptcy Law is in “low compliance”.*<sup>18</sup> More specifically, while the insolvency system defines the rights of different classes of creditors, and generally provides creditors with a constructive role in restructuring decisions, the legal and regulatory requirements for formal restructuring and liquidation are considered expensive, time intensive, and generally inefficient for creditors. This is also reflected in Mongolia’s ranking in World Bank’s Doing Business indicator “closing a business”, where in 2009 it ranked 108<sup>th</sup>.

To further close the gap between Mongolia’s corporate governance framework and Chapter IV of the OECD Principles, the Mongolia government may consider the following reforms:

- *The legal and regulatory framework should require or the MCGC encourage companies to adopt whistle-blowing policies* that encourage its employees to report corporate wrongdoings, i.e. illegal or unethical behavior. The legal and regulatory framework should further protect whistle-blowers from potential reprisals from insiders.
- *The relevant enforcement bodies should ensure that stakeholder rights are consistently enforced*, in particular those relating to employees, creditors, and the environment.
- *The legal and regulatory framework should require or MCGC recommend that key stakeholder groups are provided with (reliable and timely) information* to facilitate their participation in the governance process, in particular employees and creditors.
- *The government of Mongolia should commission an Insolvency and Creditor Rights ROSC* to help improve its ranking in World Bank’s Doing Business indicator “closing a business”, where in 2009 it ranked 108<sup>th</sup>.

#### ¶ Medium-term priorities

#### ¶ Long-term priorities

A more detailed set of recommendations can be found in Part IV. of this report on policy recommendations and country action plan.

<sup>18</sup> Mongolian commercial legislation: transition in progress, EBRD, 2005.

## CHAPTER V

## Disclosure and Transparency

## Gap analysis

**?** **Principle V.A:** Disclosure should include, but not be limited to, financial and non-financial information.

**Status: Partially implemented**

**Mongolia has partially implemented Chapter V of the OECD Principles. More specifically:**

*Listed companies are required but do not in practice publicly disclose a full set of annual audited financial statements to shareholders.* The legal framework requires all companies to prepare a complete set of audited financial statements based on IFRS—balance sheet, income statement, cash flow statement, statement of changes in equity, and notes to the financial statements—on a quarterly, semi-annual, and annual basis (Art. 10.4 AL, FRC Resolution No. 206) to the FRC and MSE, but to shareholders only annually (Art. 91.1 CL, Art. 10.1.3 SML, Art. 94.1. AL and Art. 7.1.1 Auditing Law). The FRC reported that in 2007, 78.9 percent of companies failed to submit their financial statements to the authorities and estimated that not a single company made their financial statements publicly available.<sup>19</sup> The 2008 Accounting and Auditing ROSC’s findings similarly showed critical gaps in financial reporting in terms of quality and timeliness. Market participants confirm the CG ROSC team’s findings, estimating that only four to five companies properly prepare and publicly disclose their financial statements in compliance with IFRS. Market participants cite a lack of expertise by accounting staff, lackluster enforcement, and a lack of demand for IFRS by investors as the principal reasons as to why companies fail to produce financial information in compliance with IFRS. Accounting remains a tax driven process. Companies are legally required to prepare consolidated financial reports (Art. 6.2 CL); however, few companies within group or holding structures are thought to comply with this requirement.

*Listed companies are required to provide shareholders with a management discussion and analysis (MD&A) in the annual report, however, few companies prepare annual reports.* The board is required to present its shareholders with an annual report, including a description of the company’s activities, results, changes in such activities and results from previous years, and the company’s structure, and organization (Art 94.3 CL), and is also encouraged to disclose its mission and strategy (Art. 5.7.2. MCGC). Market participants, however, stated that only four to five companies prepare and disclose annual reports, including a MD&A, of comparable quality to those found in OECD Member countries.

*Overall, there is little to no disclosure of non-financial information, despite, for the most part, being required or encouraged by the corporate governance framework,* in particular with respect to company objectives, beneficial ownership structures, remuneration policies for executive and non-executive board members, and corporate governance policies, though required or encouraged by law, regulations, or the MCGC. As previously mentioned, the lack of ownership disclosure poses challenges to regulators in enforcing key corporate governance issues, for example, with respect to related party transactions.

*The MoF develops and interprets, and the National Center for Standardization and Measurement (NCSM) approves accounting and auditing standards, which are based on IFRS, respectively International Standards on Auditing (ISA); non-financial statement disclosure standards are, on the other hand, not currently developed by an organization in Mongolia.* As previously mentioned, Mongolia has fully adapted (but not adopted) IFRS as its accounting standards for banks, companies (including non-listed SMEs), NBFIs, SOEs and other public interest entities. The process for developing, approving, and periodically reviewing accounting and auditing standards is somewhat diffuse:

- The MoF is responsible for *developing* accounting and auditing standards—essentially

<sup>19</sup> FRC 2007 Annual Report, as well as comments made by the Chairman of the FRC; see <http://siteresources.worldbank.org/INTMONGOLIA/Resources/BayarsaikhanDargaSpeechEng.pdf>

**?** **Principle V.B:** Information should be prepared and disclosed in accordance with high quality standards of accounting, and financial and non-financial disclosure.

**Status: Broadly implemented**

organizing the translation of IFRS into Mongolian and then adapting these to develop IFRS-based national accounting standards and guidelines. The MoF has insufficient resources to properly develop IFRS in a timely and qualitative manner and Mongolian Accounting Standards are based on a 2003 translation of IFRS and hence outdated.

- The NCSM and its Accounting Standards Sub-Committee *approves* accounting and auditing standards. The NCSM does not appear to have the requisite technical expertise to review complex accounting and auditing standards. The NCSM Accounting Standards Sub-Committee is chaired by the Director of the MoF's Accounting Methodology Policy Department.
- The BoM and FRC, finally, are technically responsible for *issuing* accounting regulations consistent with IFRS for banks, respectively NBFIs and companies. These regulations are, however, often out-of-date with changes made to IFRS, leading to banks and companies being required to follow adaptations of IFRS from different years.

**Principle V.C:** An annual audit should be conducted by an independent, competent, and qualified external auditor.  
**Status:** Partially implemented

***Companies are to have an independent annual audit conducted in-line with ISA, but auditor independence remains an issue.*** According to the LoA, all banks and companies are subject to an annual, statutory audit. The LoA governs Mongolia's auditing framework for companies and is based on ISA (Art. 8.1 and 8.2 Auditing Law), albeit dating back to 2003 and thus does do fully not cover key issues, *inter alia*, the roles and responsibilities of the various enforcement bodies, penalties for noncompliance, and independence.

Most external auditors do not appear to conduct their audits free from conflicts of interests, although the legal framework requires the external auditor to be independent (Art. 91.4 CL and Art. 21.1. LoA), for example, forbidding audit firms from providing non-audit services to their clients, being affiliated with their clients, or holding their securities. In practice, many audit firms do in fact provide accounting, tax preparation, and consulting services. Also, companies are required to rotate their external auditor every three years, according to a recent amendment to the LoA. Many argue that the requirement to rotate an entire firm, rather than the lead audit partner, actually runs counter to good corporate governance in that companies lose their auditor just as that auditor is able to truly familiarize itself with the company's operations; more importantly, it often requires companies in emerging markets to change the only qualified audit firm. Also, a great number of the smaller audit firms generate their audit fees from a single, large client, and may thus not be considered independent as they are effectively captured. Finally, there is no independent oversight body in Mongolia to help monitor auditor independence; boards, similarly, do not assure shareholders of the auditor's independence.

***Auditors are to be licensed or de-licensed according to specific qualification and competency criteria.*** The LoA stipulates that only audit firms licensed by the MoF are allowed to perform audits. MICPA is officially mandated with administering the professional accounting and auditing examinations; approving and enforcing the Mongolian Code of Professional Conduct and Ethics; and conducting continuing professional education. To become an external auditor, an individual is to hold a five-year certificate and then practice auditing with a MoF-licensed audit firm (of which there are currently 51). Two audit firms with international affiliations—KPMG and Ernst & Young—are licensed to practice in Mongolia. To date, there are a total of 1,718 external auditors in Mongolia, of which 355 have passed all three levels of examination (which takes approximately seven years to complete). However, the auditing examination contain important deficiencies, failing to, for example, extensively cover advanced auditing and corporate reporting. Most local audit firms are small and focus on helping their client prepare financial statements and then auditing these same financial statements, which presents a clear conflict of interest.

***The MoF enforces audit standards and is independent from the profession, with properly defined responsibilities, however, lacks the necessary resources.*** The MoF is the body designated by the LoA to oversee the audit profession. The MoF focuses its efforts on legal and regulatory compliance, but does not have the resources to conduct qualitative reviews of

how the profession is applying ISA. The MICPA does not have the legal authority but has introduced a quality assurance program for its members; however, the inherent conflict-of-interest in the profession reviewing itself typically fails to provide the necessary assurance to investors. Indeed, MICPA's Ethics Committee does not appear to effectively monitor compliance with its code of ethics as not a single action has been taken to date. Neither the MoF nor MICPA have the authority to issue sanctions or impose penalties.

*MICPA develops and interprets audit and ethics standards, but is not authorized to do so.* MICPA has adopted a Code of Ethics for the audit professions, which is based on an outdated version of IFAC's Code of Ethics (Art. 8.1-2 Auditing Law), however, is not authorized to do so.

*Company boards do not disclose to shareholders that the auditor is independent, qualified, acted with care; and of the value of non-audit work.*

*The external auditor is not formally accountable to the company's shareholders and in practice reports to the managing director or majority owner only.* The legal framework provides for the board and not shareholders to appoint the external auditor and determine his remuneration, against good practice (although the supervisory board is appointed by shareholders and effectively plays the function of the external auditor).<sup>20</sup>

*External auditors are not subject to effective or dissuasive sanctions, penalties, and/or liabilities.* Shareholders are not known to have sued their external auditors for providing false opinions or failing to carry-out their audits with the proper care. Audit firms consequently do not insure themselves against the possible risk of litigation (nor does the legal and regulatory framework require professional indemnity insurance). On the other hand, the Mongolian government recently accused two audit firms for auditing malpractice; these two audit firms failed to inform the government about financial fraud of MNT 14 billion (equivalent to US\$11,864,400) at a private commercial bank.

*Companies do not make timely disclosure of material information on a non-selective basis.* In practice, companies do not place material information on their websites or produce (informative) annual reports. Companies are required to disclose relevant information to the MoF (for tax purposes), FRC and MSE only, although the MSE posts basic summaries of financial statements on its website, if on a limited basis, and the FRC has been recently required to disclose such information, but does not appear to do so in practice. Companies do not disclose materials events and selective disclosure by company insiders, such as board members, remains an issue. Investors are, in summary, unable to obtain sufficient information about a listed company's financial performance, and must fear an uneven playing field vis-à-vis insiders.

*The corporate governance framework does not address (real or potential) conflicts of interest of credit rating agencies.* Credit rating agencies do not exist in Mongolia and so the IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies has not been incorporated into the legal and regulatory framework. The IOSCO Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest has not been fully implemented in Mongolia, though brokerages do operate in the market. Finally, the corporate governance framework does not require or encourage financial intermediaries, in particular brokers, to disclose (potential) conflicts of interest, and how these are managed.

**¶ Principle V.D:** External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.  
**Status: Not implemented**

**¶ Principle V.E:** Channels for disseminating information should provide for equal, timely, and cost-efficient access to relevant information by users.  
**Status: Not implemented**

**¶ Principle V.F:** Analysis or advice by analysts, brokers, rating agencies and others is free from material conflicts of interest that might compromise the integrity of their analysis or advice.  
**Status: Not implemented**

<sup>20</sup> See Art. 76.1.10 CL

## Recommendations

### Short-term priorities

To further close the gap between Mongolia's corporate governance framework and Chapter V of the OECD Principles, the Mongolia government may consider the following reforms:

- *Only public interest entities should be required to apply IFRS*; the MoF should develop a simplified set of accounting standards for non-listed companies and SMEs.
- *The government of Mongolian should "adopt" and not "adapt" IFRS and ISA*, i.e. directly adopt IFRS rather than adapt these into national accounting standards.
- *All relevant enforcement bodies should stringently enforce the timely disclosure of independently audited financial statements*, as well as non-financial information. Quarterly statements should be disclosed to shareholders as well.

### Medium-term priorities

- *The CL should be amended to specify that the external auditor is elected by shareholders* and not the board.
- *The MoF (and once created the independent oversight body) should implement a quality control program*, MICPA, too, should conduct quality reviews of its members.
- *The LoA should be amended to require the lead audit partner, but not the entire firm, to be rotated on a periodic basis.*

### Long-term priorities

- *The government will wish to re-evaluate the role of supervisory boards in the current control structure*, in particular vis-a-vis the external function should auditors eventually be approved by shareholders, as well as the audit committees.

A more detailed set of recommendations can be found in Part IV. of this report on "policy recommendations and country action plan".

## CHAPTER VI

## The Responsibilities of the Board

## Gap analysis

**Mongolia has partially implemented Chapter VI of the OECD Principles. More specifically:**

Mongolia follows a one-tiered board model, with both executive and non-executive directors jointly serving on the board. In practice, most boards are composed of company insiders, i.e. majority shareholders, their representatives, and executives. Companies are required to (and do in practice) have a board consisting of at least nine directors, which might be excessive considering the relatively small size of most companies. Few companies have board-level committees to focus on key issues and potential areas of conflict, in particular as regards financial reporting, nomination processes, and remuneration. Most boards meet the requisite four times per year, however, a number are not thought to meet at all. Of note is that Mongolian companies are required to have a “supervisory board”, which is elected by and accountable to shareholders and in practice serves as a form of auditor, though few such supervisory boards are thought to play a role in practice.

**¶ Principle VI.A:** Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.  
**Status: Partially implemented**

**¶ Principle VI.B:** Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.  
**Status: Partially implemented**

**¶ Principle VI.C:** The board should apply high ethical standards. It should take the interests of stakeholders into account.  
**Status: Not implemented**

**¶ Principle VI.D:** The board should fulfill certain key functions.  
**Status: Partially implemented**

*The corporate governance framework provides for a general definition of the duties of care and loyalty.* More specifically, directors and key executives are required to fulfill their duties as determined by the company’s articles of association and procedures adopted by the board, and act in good faith and in the company’s interest. The MCGC or court rulings do not expand on this definition or provide relevant case law. Of note in this respect is that both the chairman of the board (Art. 7.6 and 7.7 SML) and key offices (Art. 93.3 CL) are required to sign the annual report and financial statements, and are liable for their accuracy vis-à-vis shareholders. Of further note is that the MCGC recommends that procedures be put in place for loss adjustment and for recovery of damages to the company incurred as a result of wrongdoings of the board and, if necessary, to provide board members with liability insurance (Art. 3.3.4 MCGC).

*Board members are not required or encouraged to act in the interests of all shareholders, including minorities.* Given the high levels of ownership concentration, in practice, most board members are either majority owners themselves, or are their representatives on the board. Board members (in private and state-owned companies) are thus generally thought to act in their own interest, or that of the shareholder that appointed them, rather than in the interest of the company itself, or all shareholders.

*Boards do not set ethical standards for its members, key officers, or its employees.* More specifically, the corporate governance framework does not require or encourage companies to develop a code of ethics or conduct, and companies do not do so in practice. The corporate governance framework further does not require or encourage boards to take the interests of stakeholders into account, and few boards are thought to do so in practice. Companies are, on the other hand, encouraged to establish audit committees, whose responsibility includes, *inter alia*, the company’s compliance with relevant laws and regulations, as well as internal policies and procedures.

*The legal and regulatory framework only partially guides the board in fulfilling its key functions, in particular guiding and supervising management on behalf of the company’s shareholders, and ensuring for robust corporate governance, control and audit, and risk management structures.* Table 2 below offers an overview of the relevant legal and regulatory norms, as well as board practices, relating to the board’s main functions.

**Table 2: A review of basic board functions: law vs. practice**

1.Strategic oversight	✓	76.1.1 CL: The board sets key company policies.
	☒	In practice, the board's role is unclear, with many boards involved in the company's day-to-day management. Few boards have formal strategies or performance indicators.
2. Monitoring corporate governance practices	☒	Art. 5.7.10 MCGC: The annual report is to explain any deviations from the MCGC. On the other hand, the corporate governance framework, including MCGC, does not encourage a board to annually assess its performance.
	☒	In practice, boards are not known to set governance policies, monitor their implementation, or conduct self-evaluations.
3. Selecting/compensating/monitoring/replacing key executives	✓	Art. 76.1.8 and 9 CL: The board is responsible for selecting and removing the company's executives; and for establishing the contractual terms with key executives and the amount of bonuses to be granted to such executives.
	☒	In practice, boards select and remove executives, and determine their remuneration, though in SOEs the government effectively nominates the CEO. Succession planning is not conducted.
4. Aligning executive and board pay with long term performance	☒	Boards are not required or encouraged to develop and disclose a remuneration policy linking pay to long term performance.
	☒	In practice, non-executive directors receive little pay for their service, save for banks and the largest SOEs, and board pay and performance are decoupled.
5. Implementing transparent board nomination process	✓	66.4.4 CL: Background information on candidates to the board is submitted to shareholders. 3.4.1 MCGC: The nominating committee vets candidates, informs where they fail, and proposes candidates to the board.
	☒	In practice, shareholder nomination processes are controlled by the majority owner and opaque to outsiders.
6. Overseeing conflicts of interest	☒	Art. 89.1 CL: Independent directors are required to approve conflict of interest transactions.
	☒	In practice, boards failed to oversee and establish internal controls to warn against abusive related party transactions.
7. Overseeing financial reporting, incl. independent audit and controls	☒	Art. 18 AL: Management establishes the internal audit function. Art. 1.3.1 MCGC: The board's remit includes the internal audit.
	☒	In practice, only large banks are thought to have a relatively "robust" internal control framework—i.e. independent risk, internal audit, compliance, and control functions. In most banks and companies, the internal audit function is underdeveloped.
8. Overseeing disclosure and communications processes		Art. 5.4 MCGC: Executives are responsible for information disclosure, under the board's supervision.
	☒	In practice, boards do not generally oversee company disclosures; few companies have investor relations functions.

**¶ Principle VI.E:** The board should be able to exercise objective and independent judgment on corporate affairs.  
**Status: Partially implemented**

*Boards are encouraged to assign independent directors to tasks where there is a potential for conflicts of interest, but do not do so in practice.* More specifically companies are encouraged to ensure that at least one-third of their board members consist of independent directors (Art. 3.2.3.a MCGC) and the MCGC outlines the main role of independent directors, in-line with good practice. However, the MCGC's definition of an independent director (Art. 3.2.4 MCGC) falls short of good practice, e.g., failing to cover cases in which directors are shareholders themselves. The position of chief executive and chairman of the board has to be separated (Art. 80.3 CL), also in-line with good practice. However, in practice, most boards are composed of insiders, both in private companies (with executives and owners) and SOEs (government officials, who are nominated by ministers and rotate in and out on an *ad hoc* basis); independent directors are the exception rather than the rule.

*Clear and transparent rules on board committees.* The MCGC encourages companies to form committees, in particular on audit, remuneration, and nomination committees (Art. 3.2 MCGC), and recommends that such committees be composed of independent directors, but does not encourage companies to fully disclose the mandate, composition, and working procedures of its committees. In practice, companies have not formed board committees. On the other hand, banks, regardless of their size, are required to have a full set of committees on audit, risk, remuneration and compensation, and do in practice, though most have only recently been established and hence are not thought to operate effectively.

*The legal and regulatory framework does not guide the board and its members in fulfilling their responsibilities, and demonstrating such commitment publicly.* Companies are not required or encouraged to disclose a director's tenure; employment and work income; other board positions; and board and committee attendance records. Boards are further not encouraged to provide induction programs and ongoing training to directors.

**¶ Principle VI.F:** In order to fulfill their responsibilities, board members should have access to accurate, relevant, and timely information.  
**Status: Partially implemented**

*Executives are neither required nor encouraged to provide the board with accurate, relevant, and timely information.* Board members are in turn not encouraged to demand such information as part of their duty of care. The role of the company secretary, who helps ensure for effective information flows between the board and management, is only partially discussed in the MCGC and limited to providing information to shareholders. Only a handful of the largest banks and companies have professional company secretaries. The corporate governance framework is, finally, silent on the board's ability to access outside, free, and independent advice to assist the board in its decision-making.

## Recommendations

### ¶ Short-term priorities

To further close the gap between Mongolia's corporate governance framework and Chapter VI of the OECD Principles, the Mongolia government may consider the following reforms:

- *The MCGC should be amended to inter alia:* (i) expand on the duties of care and loyalty; (ii) encourage boards to adopt a code of ethics; (iii) better guide the board in fulfilling its key role in, *inter alia:* strategically guiding and overseeing management, reviewing corporate governance policies, and approving succession policies; and (iv) improve the definition of an independent director.
- *The CL should be amended* to require a minimum of seven directors, rather than nine.
- *Directorships in SOEs should be opened to non-executive and independent directors.*
- *All stakeholders should support the establishment of high-quality training capacity on corporate governance for directors and officers.*
- *The CL should be amended to allow companies to institute supervisory boards on a voluntary, but not mandatory basis,* or to allow shareholders to call for special audits.

### ¶ Medium-term priorities

### ¶ Long-term priorities

A more detailed set of recommendations can be found in Part IV. of this report on "policy recommendations and country action plan".

### III. Summary Table

Table 1: Status of Implementing the OECD Principles in 2009		
No.	Principle	ROSC Assessment
<b>I. An Effective Corporate Governance Framework</b>		<b>Partially Implemented</b>
I.A	Overall corporate governance framework	Partially Implemented
I.B	Legal framework enforceable /transparent	Partially Implemented
I.C	Clear division of regulatory responsibilities	Fully Implemented
I.D	Regulatory authority, integrity, resources	Partially Implemented
<b>II. Shareholder Rights and Key Ownership Functions</b>		<b>Partially Implemented</b>
II.A	Basic shareholder rights	Partially Implemented
II.B	Rights to part in fundamental decisions	Partially Implemented
II.C	Shareholders GSM rights	Partially Implemented
II.D	Disproportionate control disclosure	Partially Implemented
II.E	Control arrangements allowed to function	Broadly Implemented
I.IF	Exercise of ownership rights facilitated	Not Applicable
II.G	Shareholders allowed to consult each other	Broadly Implemented
<b>III. Equitable Treatment of Shareholders</b>		<b>Broadly Implemented</b>
III.A	All shareholders should be treated equally	Broadly Implemented
III.B	Prohibit insider trading	Partially Implemented
III.C	Board/Mgrs. disclose interests	Partially Implemented
<b>IV. Role of Stakeholders in Corporate Governance</b>		<b>Partially Implemented</b>
IV.A	Legal rights of stakeholders respected	Partially Implemented
IV.B	Redress for violation of rights	Fully Implemented
IV.C	Performance-enhancing mechanisms	Partially Implemented
IV.D	Access to information	Not Implemented
IV.E	“Whistleblower” protection	Not Implemented
IV.F	Creditor rights law and enforcement	Partially Implemented
<b>V. Disclosure and Transparency</b>		<b>Partially Implemented</b>
V.A	Disclosure standards	Partially Implemented
V.B	Standards of accounting & audit	Broadly Implemented
V.C	Independent audit annually	Partially Implemented
V.D	External auditors should be accountable	Not Implemented
V.E	Fair & timely dissemination	Not Implemented
V.F	Research conflicts of interests	Not Implemented
<b>VI. Responsibilities of the board</b>		<b>Partially Implemented</b>
VI.A	Acts with due diligence, care	Partially Implemented
VI.B	Treat all shareholders fairly	Partially Implemented
VI.C	Apply high ethical standards	Not Implemented
VI.D	The board should fulfill certain key functions	Partially Implemented
VI.E	Exercise objective judgment	Partially Implemented
VI.F	Access to information	Partially Implemented

A Principle is deemed to be **fully implemented** (\*\*\*) when 95 percent or more of a Principle’s Essential Criteria are met (see the Annex for the list of Essential Criteria, as well as the World Bank’s assessment methodology of the Essential Criteria). Where the Essential Criteria refer to standards, all material aspects of the standards are present; where they refer to practices, the relevant practices are widespread; where referring to enforcement mechanisms, there are adequate, effective enforcement mechanisms. A Principle is **broadly implemented** (\*\*) where one or more of the applicable Essential Criteria are less than fully implemented (75 – 94.9 percent) in all material respects. A Principle is **partially implemented** (\*) when 35 to 74.9 percent of a Principle’s essential criteria have been met. A **Not Implemented** (--) assessment likely is appropriate where major shortcomings exist, i.e. less than 35 percent of a Principle’s Essential Criteria have been implemented. A **Not Applicable** (n/a) assessment is appropriate where an OECD Principle (or one of the Essential Criteria) does not apply due to structural, legal or institutional features.

## IV. Action Plan and Policy Recommendations

**Table 3: Country action plan**

The following section proposes a country action plan to improve the corporate governance framework.

### 1. The MCGC should be amended and a broad public consultation process organized.

- Activity 1: Form a task force of key stakeholders to serve as a steering committee and drafting team.
- Activity 2: Organize the drafting team to produce an amended draft of the MCGC.
- Activity 3: Carry-out a review process of the MCGC with all key stakeholders, including a number of roundtable events, to allow a broad engagement of all stakeholders, and begin building buy-in, adaptation, and a common understanding and consensus of a nationally-owned set of corporate governance principles and guidelines.
- Activity 4: Implement sustained training programs based on the MCGC, targeting directors and officers of all public interest entities, as well as investors and regulators.

### 2. The regulatory institutions should ensure that the existing legal and regulatory framework with respect to corporate governance, as well as the MCGC, is strictly enforced in practice.

- Activity 1: The chairmen of the BoM, FRC, SPC, and MSE should meet with and firmly encourage key owners, chairman and key board members of banks and companies to follow all laws and regulations, as well as the MCGC, and undergo a minimum amount of training on corporate governance and related issues, with the implicit understanding that training could be made mandatory should companies not send their directors to attend.
- Activity 2: The BoM, FRC, SPC, and MSE should be vigilant in monitoring compliance with the MCGC and sector specific corporate governance regulations to ensure that corporate governance is properly being implemented. Along with the MSE, the FRC may consider developing a model corporate governance disclosure template, which can be made available online to guide all companies in their corporate governance disclosure, in particular those not actively traded.
- Activity 3: A sustained training effort should be organized and offered to company officials, regulators, and investors on how to properly report on, respectively review good corporate governance disclosure.

### 3. A number of amendments to the legal and regulatory framework should be made to ensure that the corporate governance framework fully meets good practice.

- Activity 1: Form a task force of key stakeholders to serve as a steering committee and drafting team.
- Activity 2: The task force identifies amendments to legal framework, based on this report and its own research.
- Activity 3: Conduct a stakeholder review process of amendments; comments are duly recognized and published online.

### 4. The MSE and FRC should strengthen and consistently enforce its listing rules, and begin a process of de-listing companies to restore trust in the market.

- Activity 1: Commission a study of “lessons learned” from other transition countries on how to best de-list companies and at the same time respect the rights of existing shareholders. The study should focus on:
  - The “transition path” that identifies procedures for efficiently converting companies that fit more naturally into other legal forms and other steps to reduce the number of companies that falls under the FRC’s supervision.
  - Other country experiences of how to effectively de-list companies while respecting the rights of existing shareholders.
  - Re-definitions of rules for listed companies, which will require greater oversight from the SCSSM.
- Activity 2: Take action to implement recommendation of the study, in particular with respect to de-listing companies that do not comply with the MSE’s listing rules and that are no longer actively traded.

To further close the gap between Mongolia's corporate governance framework and Chapter I of the OECD Principles, the Mongolian government may consider the following reforms:

#### Short-term priorities

- The key public sector institutions, including the MoF, BoM, FRC, MSE, and others should help raise awareness of good corporate governance by organizing or participating in corporate governance events, issuing publication on corporate governance, and generally promoting the business case for good corporate governance.
- The BoM should enforce compliance with the banking sector corporate governance regulation, and support banks in applying its principles by helping to organize conferences, seminars, and workshops. More generally, the BoM should implement the recommendations contained in the recent FSAP.<sup>21</sup> Corporate governance training should be organized for BoM staff, and corporate governance made a formal part of the supervision process.
- The FRC should strengthen its enforcement actions vis-à-vis financial intermediaries to further curb insider trading and market manipulation. To do so, their resources should be re-evaluated to ensure that they are able to carry-out their objectives (even if this jeopardizes its independence from the government over the short term). The FRC should generally be held accountable for its enforcement activities.
- Staffing, skills and pay at the FRC need to be better aligned with industry needs and international best practices for similar regulatory bodies. Training, particularly with experienced regulators overseas should be a priority.
- The MSE should strengthen its enforcement actions vis-à-vis companies in enforcing its listing rules. Their resources should be re-evaluated to ensure that they are able to carry-out their objectives. The MSE should be held accountable for its enforcement activities.

#### Medium-term priorities

- The FRC should commission a report studying other country experiences of de-listing companies while at the same time protecting the rights of shareholders.
- The FRC should publish an annual report as to how companies are applying the MCGC.
- The MSE should strengthen its listing rules and de-list companies.
- The MSE should itself lead by example and follow the MCGC.
- All legislative and regulatory bodies should actively solicit comments, organize roundtable events to explain new laws and provisions, gather feedback and buy-in, and disclose comments online. In particular the MCGC should undergo a renewed public consultation effort to better raise awareness and secure buy-in from the public sector.
- The legal and regulatory framework should be amended to ensure that all enforcement bodies have clear roles, reporting lines, and lines of responsibility and accountability. The legal and regulatory framework should be re-evaluated to ensure that laws and regulations are tailored to the different company types, implementable, and have the desired effect on economic performance.
- The Government of Mongolia should adopt the recently issued IFRS for SMEs as the new set of accounting standards for SMEs.
- All regulatory and quasi-regulatory bodies should become more transparent, in particular with respect to disclosing enforcement actions undertaken.
- Coordination between all enforcement bodies needs to be strengthened in practice.
- Given that a great majority of companies in Mongolia are SMEs, the MCGC should contain a section focusing on corporate governance issues relevant to small, unlisted, family-owned enterprises, focusing on relevant issues such as succession planning.

#### Long-term priorities

- The FRC's "project discussion" menu on its website should be updated and used on a regular basis to facilitate public discussion.

<sup>21</sup> IMF Country Report No. 08/300. Mongolia: Financial System Stability Assessment, Sept. 2008.

To further close the gap between Mongolia’s corporate governance framework and Chapter II of the OECD Principles, the Mongolia government may consider the following reforms:

 Short-term priorities

- The CL should be amended to (i) allow the board to propose but shareholders to approve the payment of dividends; (ii) allow shareholders to formally ask the board questions during the GMS, and (iii) require the board to collectively attend and answer questions during the GMS.
- The FRC should ensure that brokers distribute dividends to minority shareholders, as required by law.

 Medium-term priorities

- The CL should be amended to (i) ensure that all major corporate decisions, such as amending the company’s articles of association or waiving preemptive rights, should be subject to a two-thirds majority vote of shareholders; (ii) allow shareholders to approve a rise in the company’s authorized capital and approve the issuance of new shares, based on board decisions; (iii) clarify that shareholders are authorized to approve non-executive remuneration packages and executive compensation policies, though not executive pay, which should remain a board prerogative; (iv) require companies to publicly disclose the capital structures of company groups, shareholder agreements, and special voting rights (alternatively this could be required as part of the SML, listing rules, or encouraged by the MCGC); (iii) specify the special duty of care and loyalty directors have to shareholders during changes of control; and (iv) allow shareholders to consult with one another on issues concerning their basic rights.

 Long-term priorities

- The MCGC should be amended to encourage institutional investors to develop a voting policy, to vote in practice, and to disclose their voting policies and actual voting. The same holds true for their engagement with investee companies to help these improve their corporate governance. Finally, institutional investors should be encouraged to develop and disclose a policy for dealing with conflicts of interest.

To further close the gap between Mongolia’s corporate governance framework and Chapter III of the OECD Principles, the Mongolia government may consider the following reforms:

 Short-term priorities

- There should be closed periods during which directors and officers are barred from trading in their company’s securities and this information should be made publicly available in a timely manner to shareholders and other stakeholders.
- The FRC should rigorously enforce relevant laws and regulations to better prevent related party transactions and insider trading.

 Medium-term priorities

- The CL should be amended to require that:
  - Proposals to change the voting rights of different series and classes of shares are to be submitted for shareholder approval.
  - Companies are to publicly disclose information about its classes and series of shares.
  - The legal provision stating that a shareholder holding one percent or more of the company’s shares is able to file a derivative suit should be specified as to whether this provision refers to a single shareholder and a group of shareholders holding one percent.

 Long-term priorities

- The SML should be amended to ensure that beneficial owners are able to direct their custodian on how to vote, and to require custodians to develop voting policies and disclose these.

To further close the gap between Mongolia’s corporate governance framework and Chapter IV of the OECD Principles, the Mongolia government may consider the following reforms:

#### Short-term priorities

- The legal and regulatory framework should require or the MCGC encourage companies to adopt whistle-blowing policies that encourage its employees to report corporate wrongdoings, i.e. illegal or unethical behavior. The legal and regulatory framework should further protect whistle-blowers from potential reprisals from insiders.
- The relevant enforcement bodies should ensure that stakeholder rights, in particular those relating to employees, creditors, and the environment, are consistently enforced.

#### Medium-term priorities

- The legal and regulatory framework should ensure that company-based pension funds are overseen by independent trustees tasked to manage the fund for all beneficiaries.
- The legal and regulatory framework should require or MCGC recommend that key stakeholder groups—for example employees and creditors—are provided with (reliable and timely) information to facilitate their participation in the governance process.

#### Long-term priorities

- The government of Mongolia should commission an Insolvency and Creditor Rights ROSC to help improve its ranking in World Bank’s Doing Business indicator “closing a business”, where in 2009 it ranked 108th.

To further close the gap between Mongolia’s corporate governance framework and Chapter V of the OECD Principles, the Mongolia government may consider the following reforms:

#### Short-term priorities

- Only public interest entities should be required to apply IFRS; the MoF should develop a simplified set of accounting standards for non-listed companies and SMEs.
- The government of Mongolian should “adopt” and not “adapt” IFRS and ISA, i.e. directly adapt IFRS as passed by the IASB and IFAC’s ISA, rather than adopt these into national accounting standards.
- All relevant enforcement bodies should stringently enforce the timely disclosure of financial statements, in addition to the MD&A, within the context of an annual report.
- The MoF should as part of its licensing process assure itself that: (i) auditors carry-out their audits independently, in particular with respect to providing non-audit services to their clients and preparing financial statement for their clients; and (ii) follow ISAs and IFAC’s Code of Ethics. The MoF should be able to issue sanctions and penalties.
- The MCGC should encourage companies to: (i) make timely disclosure of material information on a non-selective basis; (ii) place material information on their websites or produce (informative) annual reports; and (iii) disclose to shareholders that the auditor was independent, qualified, and the auditors acted with care. The audit fees, too, should be disclosed to shareholders.

#### Medium-term priorities

- The MoF, FRC, BoM, and MICPA should call for and help organize a comprehensive and sustained training program on IFRS, targeting accountants and auditors, investors, and regulators.
- The MoF and NCSM should formally adopt IFAC’s Code of Ethics as the official standard for the audit profession. Alternatively, MICPA should be authorized to issue IFAC’s Code of Ethics.
- The FRC should be made responsible for developing a comprehensive and appropriate list of non-financial disclosure standards.
- MICPA should strengthen its CPA examination, in particular with respect to extending its coverage with respect to advanced auditing and corporate reporting.
- In addition to the quality review programs administered by the MoF and eventually the independent oversight body, MICPA should have the legal authority to itself conduct

quality assurance reviews for its members.

- The CL should be amended to: (i) specify that the external auditor is elected by shareholders upon a proposition of the board, and not the board itself; and (ii) ensure that the external auditor is subject to effective or dissuasive sanctions, penalties, and/or liabilities.
- The SML should be amended to require companies to: (i) disclose its quarterly statements to shareholders; (ii) implement IOSCO's Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest; and (iii) ensure that their boards are responsible for assuring themselves that the external auditor is independent and competent, and should be required to report as much to shareholders.
- The LoA should be amended to require the lead audit partner, but not the entire firm, to be rotated on a periodic basis.
- The government will wish to re-evaluate the role of supervisory boards in the current control structure, in particular vis-a-vis the external function should auditors eventually be approved by shareholders, as well as the audit committees.
- Over the long-run, the Mongolian government should establish an independent oversight body to help monitor auditor independence. The MoF, which is currently tasked with overseeing the profession, should receive additional resources to ensure that it is able to conduct quality reviews over the short to medium-term.
- The SML should, over time, implement IOSCO's Statement of Principles Regarding the Activities of Credit Rating Agencies has not been incorporated into the legal and regulatory framework.

#### Long-term priorities

**To further close the gap between Mongolia's corporate governance framework and Chapter V of the OECD Principles, the Mongolia government may consider the following reforms:**

#### Short-term priorities

- The MCGC should be amended to: (i) expand on the duties of care and loyalty contained in the CL; (ii) encourage boards to adopt a code of ethics, ensure that such code is publicly disclosed, and periodically disclose compliance against this code; (iii) better guide management in fulfilling its key functions, in particular with respect to the board's role in, *inter alia*: strategically guiding and overseeing management, reviewing corporate governance policies, and approving succession policies; (iv) disclose committee terms of reference and composition; (v) disclose a director's tenure; employment and work income; other board positions; and board and committee attendance records; (vi) provide induction and ongoing training to directors; (vii) provide the board with accurate, relevant, and timely information, and encourage directors to demand such information as part of their duty of care; (viii) improve the definition of an independent director; and (ix) encourage the board to access outside, free, and independent advice.

#### Medium-term priorities

- The CL should require: (i) board members to act in the interests of all shareholders, including minorities; and (ii) a minimum of three or five directors, rather than nine.
- Directorships in SOEs should be opened to non-government officials and include independent directors.
- All stakeholders should support the establishment of high-quality training capacity on corporate governance for directors and officers within the framework of the nascent corporate governance institutes, in particular with a view towards building sustainable local capacity.

#### Long-term priorities

- The CL should be amended to allow companies to institute supervisory boards on a voluntary, but not mandatory basis.





THE WORLD BANK

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OCED Principles of Corporate Governance.

**The ROSC assessments:**

- use a consistent methodology for assessing national corporate governance practices
- provide a benchmark by which countries can evaluate themselves and gauge progress in corporate governance reforms
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
- provide the basis for a policy dialogue which will result in the implementation of policy recommendations

**To see the complete list of published ROSC's, please visit  
[http://www.worldbank.org/ifa/rosc\\_cg.html](http://www.worldbank.org/ifa/rosc_cg.html)**

*To learn more about corporate governance, please visit IFC/World Bank's corporate governance resource Web page at [www.worldbank.org/corporategovernance/](http://www.worldbank.org/corporategovernance/)*

*Contact us at [CG-ROSC@worldbank.org](mailto:CG-ROSC@worldbank.org)*