

## **DEVELOPMENT AND FUTURE TRENDS OF ACCOUNTING**

J. Ukhertar, Director of Accounting and  
Supervision Department, MOF

Good morning Ladies and Gentlemen.

We witnessed the first step in developing the national accounting and auditing in line with international standards and overcoming transitional economy by enacting legal enforcement, such as Law on accounting in 1993 and Law on Auditing in 1996 by Parliament of Mongolia, that resulted in being legislative cornerstone for introducing legalization of accounting according to the IAS and national accounting body, which served to the national audit establishment and training certified accountants and auditors.

Today, it's apparent that these laws are not efficiently compliant with not only the rapidly growing economic and social requirement, but also sustaining future development focus. Looking back into the past, it's observed that we've gone the long way to shifting to the new accounting system and today we are facing with issue of starting the new phase of the accounting development. The new phase will comprise not only accounting, auditing, asset valuation, financial market regulation, finance, accounting of investment instruments, control issues in whole, but also issues on activity, responsibility, relationships, and legislative regulation of stakeholders.

I would like to emphasize that financial organizations and donors such as World Bank, Asian Development Bank, International Financial Corporation and JICA have played a key part in providing assistance in regulating issues of accounting, auditing and valuation in Mongolia. One of the last works that had been done is the World Bank assisted ROSC program, which reports on accounting and auditing of Mongolia and today's roundtable discussion, is aiming to these talks.

The Government of Mongolia is giving a great importance to the recommendations of World Bank experts' report on accounting and auditing system of Mongolia and its guidance on achievements and shortcomings and further improvements on legal environments.

The significance of this roundtable discussion is to identify the target goal and its implementation in respect of accounting, audit, and valuation with representatives of stakeholders from NGO, private sector, audit companies, researchers and academics. We believe that as a result of this roundtable discussion the common understanding on accounting, auditing, valuation development target focus and its implementation possibilities will be achieved.

For these reasons, I welcome the opportunity to talk with you today about current situation of accounting and auditing and further improvement of existing setting for the long run.

### **One. Current Situation of Accounting and Auditing**

Assessing current situation of accounting and auditing in Mongolia in whole we can declare that the common international setting is introduced in general. But issues such as improving, optimal utilization of reported data, and sustaining its importance lead to be the aim of sector development.

It's imperative that corporate accounting and financial reporting are considered as inseparable part of the accounting sector. Particularly, issues such as state consolidated reporting, statistical data unification, asset and population registration, accounting and its codification, software application and supreme database for accounting results. In light of such issues distribution of functions and its relationships are required for assessment.

There is quite large number of entities registered at the State registration office of National taxation authority of Mongolia, but actually very few are submitting financial reports and paying taxes. However, National taxation authority is re-registering entities by its types of taxes paid, but non-operating entities and closed business entities are not deleted from the database, which in turn causes double registration and miscounting of entities. Upon recounting of over 60 thousand entities, it results that 40.8 thousand entities entitled to submit financial reports and pay taxes, and the rest are either non-operating or separated. This factor shows number of companies that are double registered, do not produce financial reports, do not pay taxes or produce Y (checked) reports.

For example, when report on transparency initiative on mining sector was introduced, it resulted in different numbers in terms of the paid taxes and fees not only to the local budget, but also state agencies such as Mineral resources and petroleum authority, National Taxation authority of Mongolia and State Treasury.

Thus, it's imperative to create the unified (consolidated) database for state entities to utilize it efficiently in cooperation with and to create optimal environment for supervising and monitoring efficiently overall activity of entities.

Countries around the world have been transferring into the next phase of socio-economic development and calling it "Information Society". This concept represents creating independency of space from time, whereas data transmission, processing, storage and knowledge will facilitate the development information technology sector development.

In view such requirements, Ministry of Finance is paying great attention to the introduction of Information Technology to the public sector: particularly our department has conducted testing on accepting financial reports from organizations and entities in e-reporting format online. Today national taxation authority is receiving tax e-reports online, which has been implemented successfully. This testing had resulted dual benefit, which from one side it saves time for stakeholders, frees from bureaucracy and from the other hand it facilitates creating database.

This testing of receiving reports in e-format had boosted tremendously processing data on a prompt basis, consolidating data in state level, developing accounting policy. Also, this testing contributed not only in unifying income, expenses and current assets, but also in controlling false financial statements of entities. As a result, producing 2 statements, winning in procurement process, preparation statements for loan purpose is relatively been decreased.

In addition to improving of accounting and auditing setting, introducing information technology and creating central database, our next main goal is enhancing implementation of International Financial Reporting Standards. According to the research conducted in 2006 by Ministry of Finance, 73.6% of entities are using International Accounting Standards in producing financial statements. Today the usage of International Accounting Standard is relatively high in terms of the quantity, but quality issue is still remains.

Ministry of Finance requires entities and organizations to prepare financial statements according to the International Financial Reporting Standards. Today there are 28201 actively operating entities, from which 24602 or 87% are small and medium enterprises. Total of 22962 small and medium enterprises have assets up to 50 million MNT and the rest 1640 enterprises has 50-100 million MNT in assets. These small and medium enterprises are facing difficulty in implementing International Financial Reporting Standards effectively.

Ministry of Finance has required enterprises to implement International Financial Reporting Standards issued by International Accounting Standards Board, but according to these statistics, nearly 90% of the all enterprises are small and medium enterprises and remaining 10% of the enterprises are contributing 90% of the state budget.

Consequently, the publishing of “IFRS for SME (exposure draft)” in Mongolian is essential not only for businesses, but also public sector entities, accountants, auditors and valuation specialists. The translation, adoption into national standard and process is ongoing with Mongolian Institute of Certified Public Accountants.

In addition to improving SME accounting, we are also facing issues on improving accounting and unifying methods financial reporting for insurance, banking, financial and mining sector. In this instance, according to the Law on Mineral resources mining expenditures accounted as accumulated expense, which will be depreciated by straight line method, but the in Law on taxation this issue is not addressed, that at the end it created inconsistency and different ways of translating the issue. Moreover, on the issue on accounting of financing investments of mining companies we still don't have common understanding whether to account these expenses as owner's equity or as liability.

The next important issue for increasing implementation of international standard and improving accounting is professional accountants. In practice, enterprises producing two to three financial statements and they are becoming common due to limited external users. This situation is only and directly related to the accountant's liability, ethics and professionalism.

National accounting professionals are very important in the innovation of accounting system. Currently, there are 40 000 enterprises operating and functioning in Mongolia, in which 10400 accountants work in these enterprises (as contracted).

At the end of 2007 and first quarter of 2008 Ministry of Finance has conducted exam to identify degree of knowledge on accountants from Ulaanbaatar, Darkhan, Erdenet and Khuvsgul aimag that resulted in 59-69% of the participants passing successfully and it was observed that majority hadn't have sufficient knowledge on :

- Accounting of revalued assets, transaction on elimination of fixed assets,
- Classification of monetary items,
- International Accounting Standards.

This situation leads to taking systematic measures on improving professional knowledge and skills of accountants by MOF.

Today, there are 50 universities and colleges which train future accounting professionals in Mongolia and 35 % from total graduates are finishing their schools as accountants. The degree of professionalism and education is markedly different among these graduates since curriculum, requirement of schools is varying. Therefore, we have produced 5 curricular standards (including demography, economics, accounting, statistics and international economy) in collaboration with professional universities and adopted as national standard in 2008, that created the circumstances to be followed by all private and state universities and colleges that graduate bachelors of economics. This standard is beneficial that it not only sets the minimum requirement for the university graduates, but also stipulates an integrated standard for graduates.

General condition of increasing financial reporting transparency and providing correct and reliable information to stakeholders of economic relations is strengthening audit activity that is external, independent supervision. Today there are 41 companies in capital, 12 companies in aimags totaling 53 companies operating the audit. The regularity of activities, increased capacity of human resource of audit companies contributing to stable operating and quality service providing, even some companies are recognized as members of biggest international organizations.

Although it's been observed some stabilization in audit activity, there is still some shortcomings existent. Its commonly observed among audit companies that auditing is not performed completely according to standard procedures, work documents is not collected

completely, processing and analysis of work documents in incomplete, no supervision on auditor's opinion, recommendation and correction.

The basic requirement for performing audit is not fulfilled, such as contract signing with customer, collecting work documents and furthermore audit companies charge for their service 20000-30000 MNT by simply signing and stamping financial statements with errors and un-reconciled statements. Additionally, this service charge is the result of unfair competition which involves employees of financial and taxation entities. Due to all these factors we have received complaints on particular audit companies.

Following factors influencing audit sector development and clearing above stated:

1. *To change legislative environment according to the current requirements.*

Law on Accounting and Law on Auditing served as basis for regulating relations of accounting and auditing are not in compliance with development of the country, social system, reporting practice, not reflecting the truth, and furthermore it requires innovations due to its inconsistencies.

2. *Auditing service users not stabilized.*

From international perspective, the development of initial and capital markets allow to grow the development of external and independent supervision. In Mongolia, due to current stage of capital market development audit requirement is not stabilized entirely. Since management is not understanding audit requirements and not complying to provision of all related information, auditors are more of to pursue the fees and do not verify statements adequately.

3. *Shortage of professional staff.* The state from one side must regulate fair competition capacity increasing audit companies and decrease influence, and from the other hand must direct activities to increase the observance of international standards' procedures by audit companies.

Another issue facing formulating accounting system, that's in line with international requirements, is asset valuation and reflection it's results on financial statements. We are facing issues such as increasing return of assets and introducing innovations in valuation of assets. And other issues are on valuation financial statement indicators, why correct measurement is asset verification indicator, is all types of assets are fully valued and reflected in financial statements, what is the degree of knowledge of accountants and auditors on

valuation, why asset valuation for financial reporting standards is not being developed. Thus, valuation for financial reporting purpose is required to be developed fairly, independently and intensively with innovation by board of directors of the company, managers, owners, creditors, investors, insurance and taxation agencies, government agencies, consultants and experts, stock exchange, media and press.

The asset valuation is not stabilized in Mongolia because population has no sufficient knowledge on value of land and immovable assets, scarcity of asset management, little application of valuation standard, insufficient experience of valuation specialists, no database for them, and professional organization of valuation specialists has not been not stabilized and no trust for valuation specialists.

Legislative environment, professional methodological stabilization, education for valuation specialists, re-training system, independent valuation professionalism, supervision of valuation activity by state and professional organization will result in favorable state of development for valuation.

There are many works had been done in developing valuation system and stabilizing relationships between state and independent valuation activity. In 1995 first asset valuation center with membership was established that provided independent valuation service. Since privatization of state property, the revaluation of state and local property was performed in 2004, and by government resolution the next revaluation is going to be made in 2008.

Every year the demand for professional valuation specialists is increasing, but the institutional preparation of valuation specialists is an actual dilemma.

Today there are 86 people have valuation license and providing independent valuation services for valuation that are in 19 companies. Out of these valuation specialists, 40 are going to perform asset valuation for 380 budget entities.

Ever since the market economy is established in our country and different types of property is introduced the fair registration and accounting of assets and controlling is mandatory. According to Article 37.1 of the Law on public sector management and its financing, the Government consolidated financial report is issued from 2005.

Consolidated financial statement of the Government as of the end of 2007 has been prepared by plan endorsed by Minister of Finance integrating State Treasury, Government owned businesses, projects and funds in compliance with standards. In order to prepare consolidated

financial statement complied with IPSAS would require 10-15 years with all required instructions and guidelines. This process is just starting in our country. Currently, consolidated financial statement does not comprise all enterprises of government control, and land value and historical property are not reflected in the financial statement.

Today according to the Article 38.2 of Law on public sector management and its financing, financial statements of budget entities are being audited by the stated period, but the deadline of submitting statements to the Portfolio Minister for integrating into consolidated statement and auditing is not indicated yet. To comply with legal requirement and prepare consolidated statement we taking not audited financial statements.

## **Two. Future objectives**

Following measurements should be taken for accounting system in order to improve, innovate, and increase benefits to economy of Mongolia:

- 1. To introduce innovative changes in the legislative environment of accounting, auditing and asset valuation.** There is a need coordination of legislative regulation of activities, responsibilities, relationships, cooperation, supervision and monitoring finance and accounting state and non governmental organization-stakeholders such as Ministry of Finance, Mongolian National Audit Office, Bank of Mongolia, Financial Regulating Commission, Mongolian Stock Exchange, Mongolian Institute of Certified Public Accountant, Auditor's Association and Valuation associations..
- 2. To establish the consolidated database.** To improve the work relationships between the activities of state entities and provide the unification of all data among accounting organizations, create database with similar classification, codification, software, system, organization and structure. As of today Ministry of Finance, Customs administration, taxation authority has their own information network. The optimal connection of these networks will be solution for creation consolidated database. This task must be implemented by long term program, which will require not only adoption of favorable legislative environment, re-distribution of duties and government structure, but also comprising all entities and even households.
- 3. To implement the International Accounting Standards in specific sectors of the economy, establish accounting standard committee that develops standards for small enterprise accounting.** To implement IFRS for public interest organizations (particularly, companies listed stock exchange, banks, financial organizations, large

enterprises, funds and political parties) and to implement IFRS for SME for the rest enterprises. International experiences show us that additional guidance notes, instructions, methodology and manuals are published per every standard.. This issue was addressed in the recommendation from the “4<sup>th</sup> National Meeting of Distinguished Accountants, Financial specialist and Economists” of 2007 that establishing Accounting standardization committee, which consists of representatives of Accounting & Supervision Department of MOF, entities and users of financial statements.

- 4. To increase the knowledge and qualification of staff and strengthen the responsibility structure.** To control and supervise curricula and it’s contents of bachelor and post-bachelor study program, CPA issuance and re-training of accountants in compliance with international requirements. Also, the responsibility and awarding structure is required to be stated in the legislative acts.

To conclude with, we have successfully set up for last 18 years the basis of accounting, audit and valuation which are ones of main indicators of economic development. Today is the time to strengthen and improve the level that we have reached, learn from mistakes and achievements and start the perfection of accountancy, auditing and valuation.

As we all know, these issues were discussed at “4<sup>th</sup> National Meeting of Distinguished Accountants, Financial specialist and Economists” that held with over 500 representatives of financial specialists, statistics, economists, auditors, accountants from the capital and aimags, government and parliament members on October of last year. The recommendation “Accounting and auditing development medium term program” was the result of this meeting and today the detailed plan of recommendation’ and its implementation was approved by the Minister of Finance.

The recommendations we are discussing today will be reflected in the medium term program and assistance of international experts, technical assistance of international financial organizations and donors is exceptionally important in successful implementation of the program.

Therefore, we appeal you, the best professionals of national accounting, finance and economics to participate in this discussion by effectively giving your efforts and input.

Thank you for your attention.