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MONGOLIA

PUBLIC FINANCIAL MANAGEMENT PERFORMANCE REPORT

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MONGOLIA - FISCAL YEAR January 1 – December 31

EXCHANGE RATE

(As of December 25, 2014)

1 US $ = 1,890 Mongolian Tugrik (MNT)

WEIGHTS AND MEASURES

Metric system

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Abbreviations and acronyms

AGA	Autonomous Government Agency
COA	Chart of Accounts
CSC	Civil Service Council
DBM	Development Bank of Mongolia
DMD	Debt Management Division
DRC	Dispute Resolution Council
GDP	Gross Domestic Product
GDSR	General Department of State Registration
GFS	Government Financial Statistics
GPA	Government Procurement Agency
FSL	Fiscal Stability Law
GDT	General Department of Taxation
GFMIS	Government Financial Management Information System
HDF	Human Development Fund
IBL	Integrated Budget Law of Mongolia
IIA	Institute of Internal Audit
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IT	Information Technology
MED	Ministry of Economic Development
MNAO	Mongolian National Audit Office
MNT	Mongolian Tugrik
MoF	Ministry of Finance
MTEF	Medium Term Expenditure Framework
MTFF	Medium Term Fiscal Framework
PE	Public Enterprises
PFM	Public Finance Management
PPLM	Public Procurement Law of Mongolia
SAI	Supreme Audit Institution (State Audit)
SIF	Social Insurance Fund
SNG	Sub National Government
TIN	Taxpayer Identification Number
TSA	Treasury Single Account

Foreword and Acknowledgements

This report was written by a team consisting of Zahid Hasnain, Taehyun Lee, Regis Cunningham, Kofi Awanyo, Badamchimeg Dondog, Dulguun Byambatsoo, Gantuya Paniga, Altantsetseg Shiilegmaa, and Davaadalai Batsuuri, all of the World Bank; Patrick O'Connell of the US Treasury; and Giovanni Caprio, consultant. Lynn Yeargin, Ulziimaa Erdene, and Otgonbayar Yadmaa provided administrative support. The note was prepared under the overall guidance of Sudhir Shetty, James Brumby, Coralie Gevers, and James Anderson.

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Mr. Demberel S., Chairman, National Chamber of Commerce and Industry;
Ms. Oyunbadam D., Manager in charge of economic programs, Open Society Forum;
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Ms. Oyunchimeg G., Chief Accountant, School No. 53 of Ulaanbaatar;

SUMMARY ASSESSMENT

1. This Public Financial Management Performance Report (PFM-PR) is the first assessment of Mongolia's PFM system using the Public Expenditure and Financial Accountability (PEFA) framework.[1] The report aims principally to establish an objective baseline measure of current PFM performance, highlighting areas of absolute and relative strength and weakness, thereby enabling a stock-taking of over a decade of PFM reforms in Mongolia and guiding the Government in its reform priorities.

2. The assessment covers public financial management at the budgetary central government level[2]. The PEFA is an evidence-based methodology that measures the performance of a country's PFM system at a particular point in time using a set of standardized indicators. The assessment is done on six dimensions of an open and orderly PFM system identified by the Framework, which are:

    1. ***Credibility of the budget:*** The budget is realistic and is implemented as intended
    2. ***Comprehensiveness and transparency:*** The budget and the fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public.
    3. ***Policy-based budgeting:*** The budget is prepared with due regard to government policy.
    4. ***Predictability and control in budget execution:*** The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.
    5. ***Accounting, recording and reporting:*** Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.
    6. ***External scrutiny and audit:*** Arrangements for scrutiny of public finances and follow up by the executive are operating.

3. Against these six core dimensions of PFM performance, the set of 28 high-level indicators measure the operational performance of the key elements of Mongolia's PFM systems, processes and institutions of the budgetary central government. In addition, the PFM-Performance Report (PR) uses the indicator-based analysis to develop an integrated assessment of the PFM system against the six critical dimensions of PFM performance and evaluate the likely impact of PFM weaknesses on the three main budgetary outcomes of aggregate fiscal discipline, strategic resource allocation, and efficient service delivery.

Integrated assessment of PFM performance

Credibility of the Budget

4. The Budget of the Government of Mongolia ("the State Budget") has low credibility as evidenced by deviations of over 15 percent in each of the past three years (2011-2013) between planned expenditures in the originally approved budget by the State Great Khural (Mongolia's parliament) and actual expenditures at the end of the budget year; and deviations of over 20 percent in two of the past three years between planned and actual revenues. This lack of credibility has required mid-year amendments to the budget by the parliament in each of the three years in order to meet the targeted fiscal aggregates.

5. The reasons for low budget credibility are twofold. First, given the budget's high mineral resource dependency, there is a structural volatility in the economy, which creates difficulties in budget planning, particularly revenue forecasting. The Ministry of Finance (MoF), and the other agencies that provide MoF with relevant

[1] PEFA framework was developed by the PEFA partners — the World Bank, the IMF, the European Commission, the United Kingdom Department for International Development, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign affairs and the Swiss State Secretariat for Economic Affairs — in 2001:.

[2] For more details please refer to Section I, Introduction

source data, are in the process of developing the technical capacity to address this structural constraint effectively and produce good forecasts. Second, and more importantly, there is a political imperative to expand budget spending, which has resulted in overly optimistic forecasts of the key macroeconomic parameters (e.g. GDP growth, imports, and mineral production) and therefore unrealistically high revenue projections.

6. Lack of budget credibility has downstream implications for the entire budget cycle, as detailed below. It has also resulted in an accumulation of arrears of 4 percent of total expenditures in 2013, a significant increase over the previous fiscal year, almost entirely due to arrears from capital projects.

Budget transparency and comprehensiveness

7. Mongolia has made good progress in increasing the comprehensiveness of information included in the budget, as measured by the types of documents that are submitted to the parliament for deliberation and approval, in the public disclosure of this information, and in setting transparent criteria for inter-governmental fiscal relations. These achievements are largely the result of a set of reforms that were enshrined in the integrated Budget Law (IBL) adopted in 2011. The annual budget package meets 8 of the 9 documentary requirements. Public disclosure of fiscal information has been steadily increasing since 2006 and now includes the annual budget documentation at the time of submission to parliament, in-year budget execution reports, year-end financial statements, external audit reports, contract awards, and Information on resources available to primary service units. The IBL initiated significant fiscal decentralization in Mongolia and instituted rule-based intergovernmental fiscal transfers which, combined with the rapid increases in government revenues, provide sub-national governments with generally predictable additional funds to deliver services.

8. The rapid growth in unreported extra-budgetary financing of government capital projects however, greatly compromises the accuracy of the information in the annual budgetary documentation, and reduces fiscal transparency. These government operations are financed by loans from the Development Bank of Mongolia (DBM), which in 2013 was equivalent to 28 percent of total central government expenditures (including the Human Development Fund and Social Insurance Fund) and was roughly equivalent to on-budget capital projects. Neither the medium term fiscal framework nor the annual budget provides information on the extra-budgetary operations, thereby greatly compromising their realism; financing sources of these extra-budgetary activities are however, included in the calculation of the debt stock that is presented as part of the budget documentation. In addition, inconsistencies in the chart of accounts used for budget planning and for budget execution also reduces the quality of fiscal information as some expenditure items, such as programs, cannot be reported and others require some estimation in order to be reported.

9. A related weakness is the limited oversight of fiscal risks of state-owned enterprises, including but not limited to the DBM. While state-owned enterprises are required by law to produce, and do produce, annual audited financial statements which are incorporated into the Annual Consolidated Financial Statements of the Government that are approved by the parliament, these statements run into several hundred pages and are not accompanied by an overall report that provides an overview of the fiscal risks stemming from state-owned enterprises.

Policy-based budgeting

10. The annual budgeting exercise is undertaken in a generally well-regulated and orderly manner. The IBL specifies the budget calendar in great detail, and this calendar is adhered to and provides line ministries with sufficient time (approximately 5 weeks) to prepare their annual budgets. The budget circular is a clear and comprehensive document consistent with the MTFF which on paper provides sufficient guidance to ministries. Ministries however, do not use this guidance effectively and in general do not abide by the ceilings in preparing their budget estimates which reduces the utility of the ceilings in encouraging prioritization.

The parliament approves the budget in a timely manner and in adherence to the budget calendar.

11. A multi-year perspective on budgeting is however, lacking. While de jure the Fiscal Stability Law (FSL) and the IBL specify the preparation of an MTFF with multi-year fiscal forecasts, the coverage of the MTFF is limited and does not include off-budget expenditures, the forecasting of the main fiscal aggregates is poor, and the links between subsequent MTFFs and between the MTFF and the annual budget are weak. The MTFF is therefore not achieving its objective of providing a hard budget constraint. The Government produces a number of national and sectoral planning documents, but these are not reconciled with the MTFF (or formulated within a realistic fiscal envelope) and generally do not have a reasonable costing of investments and recurrent expenditures. Budgeting for investment and recurrent expenditure are two separate processes with the former the responsibility of the Ministry of Economic Development (MED) and the latter the responsibility of the MoF, with little or no coordination between them. While the IBL mandates that recurrent cost estimates of capital projects be prepared and included in the budget, this is being done only sporadically.

Predictability and control of budget execution

12. Mongolia's PFM system has mixed performance in the predictability and control of budget execution. Good progress has been made in tax administration, particularly with regards to the transparency in taxpayer obligations; tax collections; in the functioning of the Treasury Single Account (TSA); and the expenditure limits exercised through the Government Financial Management Information System (GFMIS, Mongolia's treasury system), with the notable exception of payroll controls which are weak. The excessive use of extra-budgetary funds also compromises procurement, as the bulk of the procurement done from these funds uses non-competitive procedures. The non-credibility of the budget, with overly optimistic revenue forecasts, hurts the predictability in the availability of funds to line ministries given that cash management is weak and largely based on expenditure controls and cash rationing with MoF changing monthly budget allotments regularly and with little advance notice. It has also resulted in increased use of discretionary audits by the General Department of Taxation (GDT) to meet the high revenue collection targets, which hurts the business climate.

13. To briefly elaborate:

<u>Tax administration</u>: Mongolia is a self-assessment based system and tax obligations are clear for most laws, and taxpayers have good access to information. There are weaknesses in taxpayer registration arising from the multiple systems currently in use that are not well integrated, increasing use of ad hoc audits, and a weak regulatory framework for dispute resolutions. The tax collection system is generally efficient, and funds are transferred daily to the TSA.

<u>Cash and debt management</u>: Cash management is weak and largely based on expenditure controls and cash rationing. Debt recording is complete, although only reconciled quarterly, but a major weakness is that the government's incurrence of debt and issuance of guarantees are approved by the MED and MoF respectively without a unified overview mechanism. The cash balances in the TSA, which accounts for all government transactions except extra-budgetary funds, are reconciled daily.

<u>Payroll controls</u>: Personnel records and payroll are decentralized in each of the over 5000 budgetary organizations. Payroll is on the basis of budgeted positions and not actual positions, resulting in inconsistencies between the payroll and the personnel records. Personnel records are updated only annually but there are significant irregularities in the data reported to the different central agencies. Payroll audits only take place infrequently.

Procurement: The regulatory framework for budget procurement is generally comprehensive and transparent, makes open competitive procurement the default method of procurement, and provides adequate public disclosure. This framework however, does not apply to projects financed by the DBM which undermines the comprehensiveness and transparency of the procurement system, particularly given the scale of direct contracting of projects financed by DBM loans and with limited public disclosure. Another area of weakness is the lack of representation from the private sector and civil society on the two complaints bodies.

Internal control: There are no expenditure commitment controls. Instead, the budget is executed based on a monthly budget allotment schedule that establishes expenditure limits, which are revised and adjusted every month. Other internal rules and procedures incorporate a comprehensive set of controls, which are excessive for the capital budget. Compliance with the rules is high.

Internal audit: The internal audit function only began in 2012 when authorized under the IBL and has been progressing well with most ministries having full time auditors. The weaknesses largely relate to the newness of the internal audit function as many of the newly created audit units do not yet consistently meet professional standards, and the reporting schedule to MoF and the Mongolia National Audit Office is not fixed. There are some delays in the follow-up actions to the internal audit reports.

Accounting, recording and reporting

14. The accounting, recording and reporting practices are generally strong. Confirmation of the consolidated balance of the TSA is done daily between the Bank of Mongolia (the central bank) and the Treasury Department. Information is received monthly on the budget allocations and expenditures of service delivery units (primary schools and basic health facilities), which are used to produce monthly budget execution reports. These reports reveal that front-line service delivery units receive resources without delay and spend most of their budgets. The inconsistencies in the chart of accounts used for budget planning and for budget execution however, compromise the quality of these reports. The accounting basis is consistently disclosed. However, reporting is not in full compliance with the International Public Sector Accounting Standards (IPSAS). The GFMIS is not used to prepare financial reports, which are instead prepared using desktop systems, resulting in task duplication and inefficiencies.

External scrutiny and audit

15. The State Great Khural (the national parliament of Mongolia) exercises considerable authority over fiscal matters and the budget. It approves the MTFF, the annual development vision, the annual budget, and supplementary budgets, and its procedures for review, involving internal organizational arrangements, are firmly established by Law, provide the parliament with sufficient time for deliberation, and are strictly abided by. Clear rules are specified for in-year amendments in the IBL and they put strict limits on in-year budget amendments by the executive.

16. The parliament pays less attention to external audit reports which weakens the accountability of Government. All entities of central government are audited annually, either by the MNAO or by auditing firms. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues, and audit reports are submitted to legislature in a timely manner, with clear evidence of follow up on MNAO's audit recommendations. Parliament however, only does a cursory review of these audit reports and approves the reports with no recommendations.

Table 1: Mongolia's scores on the PFM performance indicators[3]

	A. PFM RESULTS: Budget credibility	**Score**
PI-1	Aggregate expenditure out-turn compared with original approved budget	*D*
PI-2	Deviations in budgetary expenditure compared with approved budget	*C+*
PI-3	Deviations in aggregate revenue out-turn compared with original budget	*D*
PI-4	Stock and monitoring of expenditure payment arrears	*C*
	B. KEY FEATURES OF ALL STAGES: Comprehensiveness and transparency	
PI-5	Budgetary classification	*C*
PI-6	Comprehensiveness of information included in budgetary documentation	*A*
PI-7	Extent of unreported government operations	*D+*
PI-8	Transparency of inter-governmental fiscal relations	*A*
PI-9	Oversight of aggregate fiscal risk caused by other public sector bodies	*C+*
PI-10	Public access to key fiscal information	*A*
	C. BUDGETARY CYCLE	
C(i) Policy-based budgeting		
PI-11	Orderliness and participation in the annual budget process	*A*
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	*C*
C(ii) Predictability and control in budget execution		
PI-13	Transparency of taxpayers' obligations and liabilities	*B*
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	*C+*
PI-15	Effectiveness of tax collection	*C+*
PI-16	Predictability in availability of funds for commitment of expenditure	*D+*
PI-17	Recording and management of cash balances, debt and guarantees	*C*
PI-18	Effectiveness of payroll controls	*D+*
PI-19	Competition, value for money and controls in procurements	*D+*
PI-20	Effectiveness of internal controls on non-salary expenditure	*D+*
PI-21	Effectiveness of internal audit	*C+*
C(iii) Accounting, recording and reporting		
PI-22	Timeliness and regularity of accounts reconciliation	*B+*
PI-23	Availability of information on resources received by service delivery units	*A*
PI-24	Quality and timeliness of in-year budget reports	*C+*
PI-25	Quality and timeliness of annual financial statement	*C+*
C(iv) External scrutiny and audit		
PI-26	Scope, nature and follow-up of external audit	*B+*
PI-27	Legislative scrutiny of the annual budget law	*B+*
PI-28	Legislative scrutiny of external audit reports	*D+*

Evaluation of the impact of PFM weaknesses on budgetary outcomes

17. This detailed assessment of Mongolia's PFM system based on the 28 indicators in the 6 dimensions impacts performance in the three overarching areas of fiscal discipline, the strategic allocation of resources, and service delivery.

[3] For more details on scores and scores of dimensions please refer to Annex 2

Fiscal discipline

18. Despite significant regulatory fiscal and budget reforms over the past five years fiscal discipline is weak in Mongolia due to poor budget credibility and limited budget comprehensiveness and transparency. The overly optimistic macroeconomic assumptions and revenue forecasts used in the preparation of the MTFF and the annual budget, and the government's incurrence of debt and issuance of guarantees to finance extra-budgetary spending with limited coordination between the MED and MoF, weaken the fiscal rules enshrined in the FSL. As a result the fiscal deficit is over 10 percent of GDP with negative impacts on inflation and current account balances. These fiscal risks are also not being consolidated and systematically analyzed by the Government, or adequately publically disclosed.

Strategic allocation of resources

19. Annual budgeting in Mongolia is well regulated and orderly which, combined with the considerable scrutiny that parliament exercises over the executive's budget proposal, allows for the Government's strategic priorities to be reflected in the budget. However, the absence of a medium term perspective in budgeting, particularly with regards to the rapidly increasing capital spending (both on- and off-budget), and the weak coordination between the MoF and the MED in the preparation of the recurrent and capital budgets respectively compromises the strategic allocation of resources, as exemplified by the absence of costing of future recurrent expenditures for capital projects. Lack of budget credibility, which creates unpredictability in budget execution due to unplanned reallocations and regular in-year budget amendments, also hurts allocative efficiency. The negative impact is most clearly seen in the capital budget which is significantly under-executed and leads to the accumulation of arrears.

Efficient service delivery

20. Thanks to the regularity of the annual budget process, and the functional TSA and GFMIS, schools and basic health units receive resources on time and as per the budget plan, and this information is accurately accounted for and audited, and made publically available, representing a significant achievement of Mongolia's PFM reforms over the past decade. The weak predictability and control in budget execution of capital projects however, in particular the absence of competition and transparency in the procurement procedures used for off-budget capital spending, combined with the limited review of external audit by the parliament, reduces the value for money of the largest share of public spending (equal to 30 percent of total expenditures).

Planning and reform perspectives

21. The Government of Mongolia has undertaken significant PFM reforms of the past decade. In many ways these reforms have followed the textbook "basics first" sequencing, with an emphasis in the period 2003-2008 on strengthening internal controls, cash management, and accounting and reporting, followed by the a focus since 2008, roughly coinciding with the mineral resource boom, on improving fiscal policy, budget planning, and greater decentralization of expenditure responsibilities to local governments.

22. The medium-term reform program is well understood by the MoF and is essentially the effective implementation of the FSL, IBL, and PPLM, and this reform program is being supported by Mongolia's development partners. There are three major institutional factors however, that comprise the effective planning and implementation of these reforms. First, the MoF's reform priorities are not shared by all concerned parties, in particular the MED, which weakens the overall coordination and coherence of the PFM system. Second, an underlying constraint has been the implementation gap between the laws and the capacity of the key agencies to implement these laws. Third and most importantly, is the significant

politicization of public financial management and these informal political economy institutions serve to weaken the formal PFM institutions.

23. The great strength of Mongolia's government system, and society, is openness, not just of fiscal and budget transparency, but of the broader political process, with active citizen engagement in a variety of dimensions. The Government has also undertaken a number of regulatory measures over the past five years to institutionalize citizen participation, which include becoming a member of the international Open Government Partnership, passing a Right to Information Act (2012), formalizing participatory budgeting in the IBL, and formalizing citizen monitoring of procurement in the PPLM. Transparency and citizen engagement can help align the informal institutions with the formal PFM institutions to better achieve fiscal sustainability, strategic allocation of resources and efficient service deliver so that Mongolia's vast mineral resources can be used to better the lives of its citizens.

Section 1: Introduction

Objective

1. This is the first PEFA assessment for Mongolia and it comes at an important juncture as the country has been undergoing rapid, mineral resource fueled economic growth and fiscal expansion over the past decade. Overall government expenditure has increased from 34 percent of GDP in 2003 to 45 percent in 2013, with spending expanding 2.6 fold in nominal terms between 2010 and 2013. As public expenditures are increasingly playing an important role in economic growth and social development, an open and orderly PFM system — which results in fiscal discipline, the strategic allocation of budget resources, and efficient service delivery — is essential to translate the narrow and enclave mining-led growth into broader and sustainable improvements in the welfare of citizens.

2. This report has three main objectives:

    - To provide a rigorous stock-taking of Mongolia's PFM system using a standardized, widely accepted methodology which will establish a baseline measurement of the PFM system;
    - To help underline the main strengths and weaknesses in the PFM system and identify priority areas of reform for the Government;
    - To enable the Government, in particular the Ministry of Finance, to institutionalize the key PFM performance indicators in its own monitoring and evaluation framework to track progress with these reforms.

3. Mongolia has been undertaking public financial management reforms over the past decade, with significant support from the World Bank, IMF, ADB, and other development partners. This PEFA assessment will complement the considerable work that has already taken place on public expenditure management, which includes regular economic updates, public investment reviews, procurement reviews, analytic work conducted and supported by the World Bank funded technical assistance projects, as well as technical assistance mission reports of the IMF.[4]

PEFA report preparation process

4. The assessment was done by a World Bank team in close collaboration with the Government, in particular the main counterparts — the Ministry of Finance (MoF), Ministry of Economic Development (MED), the Mongolia National Audit Office (MNAO), the General Department of Taxation (GDT), the Government Procurement Agency (GPA), select line ministries and relevant Standing Committees of the Parliament including Economic Policy and Budget. The World Bank team carried out assessment missions to the country between March and July 2014 to: (i) hold discussions and consultations for the PEFA indicators; and (ii) present preliminary results to the Government and other stakeholders, including briefings to development partners. An orientation seminar was held in March 2014 for stakeholders and donors to explain the objectives, concepts and methodology underlying the PEFA framework. Stakeholders outside the Government were also extensively consulted to ensure the credibility and quality of the assessment. In particular, the views of the civil society and private sector (e.g., Chamber of Commerce, Association of Audit Companies) were taken into account to triangulate the information from government sources, including perceptions of the efficiency of government services.

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[4] World Bank, 2008. *Mongolia Public Expenditure and Financial Management Review*. World Bank 2013. *Mongolia: Strengthening Public Investments to Meet the Challenge of Scaling up Infrastructure.* World Bank. *Mongolia Economic Update* (various years). International Monetary Fund Fiscal Affairs Department TA reports on strengthening the medium term fiscal framework, and on improving the budget process. Consultant reports on the inter-governmental fiscal transfer system, and on strengthening tax administration.

Report preparation methodology

5. The assessment was conducted following the PEFA methodology as elaborated in the PEFA Fieldguide of May 3, 2012.[5] Two training workshops were conducted in Ulaanbaatar by the PEFA Secretariat at the start of the assessment mission — one for the task team and the other for the key Government stakeholders. The assessment was done through interviews of the above-mentioned stakeholders, review of the relevant laws and regulations, and analysis of relevant fiscal data. It also drew, as necessary, on the significant body of existing technical assistance reports and analytical work noted above. The PEFA Check requirements (quality assurance by at least 4 PFM institutions) were followed and the Concept note, the draft and final report were subject to quality assurance and peer review by the Government, the WB, the IMF and the PEFA Secretariat.

Scope of evaluation as established in the report

6. The report assesses the performance of Mongolia's PFM system of the budgetary central government for 2011-2013. According to the 2001 Government Finance Statistics Manual, the budgetary central government is defined as the central government units covered by the central government budget. As of end-2013, the budgetary central government consisted of sixteen line ministries and other budget entities including the Office of the President, the Office of the Prime Minister and the parliament. The assessment excludes the other entities that constitute the general government —autonomous agencies (the Human Development Fund (HDF) and the Social Insurance Fund (SIF), local governments, and the Development Bank of Mongolia (DBM) which carries out budgetary activities outside the scope of the official central government budget.

7. Table 2 shows the composition of general government expenditures. In 2013, the budgetary central government expenditures accounted for 60.9 percent of total public expenditures including all transfers provided to local governments, HDF and SIF. The two autonomous agencies (HDF and SIF) carry out budgetary operations separately from the central government budget relying on their own revenue sources specified by the respective laws and financial support from the central government. In 2013, the expenditures of the two funds excluding financial support from central government budget accounted for 11 percent of total public expenditures. Expenditures of local governments—21 aimags and the Ulaanbaatar City government—excluding the revenue transfers from the central government accounted for 8.6 percent of total public expenditures. However, if the central government transfers are included, total spending at the local government level reaches 23 percent of total public expenditures as the central government transfers provide significant financial support to service deliveries and development projects of the local government. The extra-budgetary spending of the DBM accounted for 19.7 percent of total general government expenditure.

Table 2: General Government Expenditure Entities (2013 Actual Outturn)

Institutions	Number of entities	Total expenditure (in billions of MNT)	% of general government expenditure
Total General Government Entities	59	7,680	100%
Of which:			
Budgetary Central government	34	4,683	60.9%
Autonomous Government Agencies	2	813	10.5%
Sub-national Governments	22	668	8.6%
Extra-budgetary Entity	1	1516	19.7%

Source: 2013 Budget Execution Report, MoF

[5] www.pefa.org

Section 2: Background Information about the Country

Subsection 2.1: Description of the country's economic situation

Country Context

8. Mongolia over the past decade has been undergoing a major transition from a largely livestock-based economy to a minerals-based one. Real economic growth has averaged 9 percent since 2003 when the mining boom began to emerge. Economic growth further accelerated into double-digits between 2011 and 2013 thanks to a surge in largely mining-related foreign direct investment and continued economic stimulus policy measures from fiscal and monetary policies. While economic growth will likely soften in 2014 from its peak of 17.5 percent in 2011, continued development of massive mineral resources of the country, largely from the Oyu Tolgoi copper and gold mine and the Tavan Tolgoi coal mine, will likely provide momentum for relatively strong economic growth in the medium and long term.

9. This rapid economic growth has brought welfare improvements to Mongolia's people, with the poverty headcount declining from 39.2 percent in 2010 to 27.4 percent in 2012. Substantial progress has also been made in regard to several Millennium Development Goals (MDGs) at the national level, though significant regional disparities remain.

10. Mongolia however, faces risks that resource wealth may not be used for sustained broad-based economic growth and welfare improvements. Mining production is an enclave activity with few linkages to other sectors of the economy and with limited direct employment creation. While the mining sector in Mongolia accounts for around 20 percent of GDP and 85 percent of exports, it only employs 4 percent of the labor force. Resource rich countries also have to deal with significant challenges of mineral market volatility and real-exchange rate appreciation due to the well-known "Dutch Disease" symptoms. Mongolia witnessed first-hand the problems posed by minerals market volatility in 2008-09 when mineral prices collapsed and resulted in an economic crisis. Economic vulnerabilities have substantially increased again in recent years as macroeconomic policies have been overly loose in Mongolia over the past two years with public expenditures growing over twofold in real terms between 2010 and 2013, the fiscal deficit reaching over 10 percent of GDP in 2012 and 2013 (including extra-budgetary funds). The combination of deteriorating external environment and the continuation of artificial economic stimulus has led to persistent pressure on the balance of payments and high inflation. And, mineral resource rents also significantly increased opportunities for rent seeking behaviors, a risk that is particularly acute in Mongolia given the scale of the national resources, and the small size of the economic and political elite that are closed connected with each other.

11. Mongolia's key development challenge is therefore, to ensure that the mineral resources are successfully translated into a solid foundation for the sustainable improvement in the lives of current and future generations of its citizens through effective and efficient use of mineral revenues. This underlines the centrality of a sound public financial management (PFM) system that will support aggregate fiscal disciple to ensure macroeconomic sustainability, the strategic allocation of resources in line with national and sectoral priorities set by the government, and efficient service delivery.

Overall government reform program

12. Mongolia's PFM system has evolved rapidly over the past decade, both in terms of the regulatory and institutional architecture and the capacity of central finance authorities and other key stakeholders. A host of regulatory and institutional changes have taken place, the most significant of which are:

- The passage of fiscal responsibility legislation — the Fiscal Stability Law (FSL, 2010) — to reduce the risks of macroeconomic instability stemming from volatile minerals market fluctuations through the requirement that the annual budget should abide by fiscal rules to reduce expenditure volatility, limit the growth of government expenditures, and restrict public debt level for long term fiscal sustainability;
- The passage of an integrated Budget Law (IBL, 2011) which impact all aspects of budgeting, and significantly decentralizes expenditure responsibilities to sub-national governments;
- A revised Public Procurement Law of Mongolia (PPLM, 2011) which changes the organizational arrangements for public procurement, and enhances transparency, including through citizen oversight;

13. At the same time there are significant gaps in the implementation of these laws. For example, there are several provisions of these laws that need to be clearly spelled out in their implementing regulations in order to ensure that all stakeholders have a clear understanding of the new modalities. Other laws, such as the Law on the Development Bank of Mongolia, will likely undermine these legislative reforms, particularly in light of the countervailing pressures for significant off-budget financing of infrastructure projects. Large off-budget spending through the DBM has rendered the Fiscal Stability Law ineffective. Corruption is a significant concern, particularly because of the close relationships between political, mining, and construction industry circles which reformers have also been trying to address through the recent passage of the Law on Conflict of Interest (2012) and the Right to Information Law (2011). Coordination has been weak between the key agencies involved in public expenditure framework, especially between the Ministry of Finance in charge of overall budget plan and the Ministry of Economic Development that controls the capital budget, which compromised the effectiveness of the IBL.

Subsection 2.2: Description of Budgetary Outcomes

Fiscal Performance

14. The central government budget has been in deficit over the last three years. Table 3 shows that the overall budget deficit reached 5.4 percent of GDP in 2011 and slightly declined to 3.3 percent of GDP in 2013. The improvement of budget deficit was due to the Fiscal Stability Law (FSL) that came into effect in 2013. The Fiscal Stability Law requires that the structural deficit of the general government budget be kept within two percent of GDP from 2013 and the official budget spending was controlled to meet the deficit ceiling of the FSL by the budgetary authorities. Total central budget revenue displayed strong performance reaching 25.4 percent of GDP in 2013 amidst strong minerals market and surging FDI inflow. In 2012 and 2013, the budget revenue to GDP ratio dropped to around 21 percent as the minerals market weakened and the FDI inflow declined. Total expenditure remained around 25 percent of GDP in 2012 and 2013 and interest payments rose from 0.3 percent of GDP in 2011 to 1.4 percent of GDP in 2013 due to increasing debt service for the sovereign bond (Chinggis bond) that was issued in 2012. Current expenditure remained around 18 percent of GDP while capital expenditure to GDP ratio declined to 6.3 percent in 2013, down from 12 percent in 2011.

15. However, the central budget data needs to be interpreted with caution as there have been significant extra-budgetary activities in 2012 and 2013. Table 4 shows the fiscal trend of the general government budget. The general government budget deficit reached 10 percent of GDP in 2012 and narrowed to 8.9 percent of GDP in 2013 due to the substantial amount of extra-budgetary activities was carried out through the DBM. The DBM financed a signification portion of capital spending using the proceeds of the DBM bond of US$580 million that was issued under the direct guarantee of the government in 2012 and the sovereign bond (known as Chinggis bond) of US$1.5 billion that was issued in 2013 by the Government of Mongolia. The large increase in interest payment of the budget in 2013 reflects growing debt service amount for these bonds. The proceeds of these bonds were used to finance large infrastructure projects many of which were implemented by the line ministries of the government, outside the control of the official budget and the Fiscal Stability Law. The extra-budgetary spending of the DBM reached 3.7 percent of GDP in 2012 and mounted to 8 percent of GDP in 2013.

Table 3: Central government operations

(As percentage of GDP)

	2011	2012	2013
TOTAL REVENUE	**25.4%**	**20.9%**	**21.2%**
Government Revenues	25.4%	20.7%	21.2%
Grants	0.0%	0.1%	0.0%
TOTAL EXPENDITURE	**27.5%**	**26.2%**	**24.5%**
Current expenditure	15.5%	18.2%	18.2%
Wage and salaries	5.5%	6.5%	4.0%
Interest payment	0.3%	0.6%	1.4%
Capital expenditure	12.0%	8.0%	6.3%
Overall Central Government Balance	**-2.1%**	**-5.4%**	**-3.3%**
Primary Balance (Central Government)	**-1.8%**	**-4.7%**	**-1.9%**

Sources: Budget Execution Report, MoF

Table 4: General Government Operations

(As percentage of GDP)

	2011	2012	2013
TOTAL REVENUE	**33.9%**	**29.8%**	**31.3%**
Own Revenues	33.9%	29.7%	31.3%
Grants	0.0%	0.1%	0.0%
TOTAL EXPENDITURE	**37.9%**	**39.8%**	**40.2%**
Current expenditure	24.6%	26.5%	23.8%
Wage and salaries	6.1%	7.2%	7.3%
Interest payment	0.3%	0.8%	1.4%
Capital expenditure	13.4%	9.5%	8.4%
Extra-budgetary capital expenditure of the DBM	0.0%	3.7%	8.0%
Overall General Government Balance	**-4.0%**	**-10.0%**	**-8.9%**

Sources: Budget Execution Report, MoF, World Bank staff estimates

Resource Allocation

16. Mongolia's budget execution report does not include sectoral allocation of budget expenditures. The World Bank team estimated sectoral budget allocation based on administrative classification by budgetary heads of the budget execution report. Further work is required for more accurate sectoral composition of the budget. Table 5 shows that education has been taking the largest sectoral allocation of the central government budget, followed by health, construction and health sectors. Table 6 shows the central government budget allocation by economic classification. The recurrent expenditure accounts for close to 80 percent of total expenditures of the central government and the interest payment accounted for 4.5 percent of total central government spending in 2013, up from 0.8 percent in 2011. Expenditure share of subsidies and transfers also significantly increased over the last three years from 13% to 32% as the amount of inter-government transfers was raised to finance local development and delivery of services delegated to local governments under the Integrated Budget Law. Expenditure share of wages and salaries and purchase of goods and service have on a rising trend until 2012 but their expenditure shares dropped to 13 percent and 10 percent respectively in 2013, reflecting downward adjustment of recurrent budget in 2013 amidst weak revenue outturn.

Table 5: Actual budgetary allocations by sectors: Budgetary central government

	2011	2012	2013
Defense	2.9%	3.9%	3.4%
Justice system	7.2%	9.1%	8.9%
Environment, Culture and Tourism	2.4%	5.0%	3.6%
Health	8.9%	10.8%	8.9%
Education and Science	17.9%	22.8%	20.2%
Social protection and Labor	21.6%	7.0%	11.9%
Agriculture and Industry	5.8%	3.5%	3.0%
Construction and Roads	13.3%	13.5%	12.8%
Mining and Energy	4.9%	5.3%	3.4%
Others	14.9%	19.1%	23.9%

Sources: Budget Execution Report, MoF, World Bank staff estimates

Table 6: Actual budgetary allocation by economic classification: Budgetary Central Government
(as percentage of total expenditure)

	2011	2012	2013
Current expenditure	**77%**	**77%**	**81%**
Wage and salaries	15%	19%	13%
Goods and services	13%	13%	10%
Interest payment	0.8%	1.9%	4.5%
Subsidies and transfers	13%	18%	32%
Capital expenditure	**23%**	**23%**	**19%**
TOTAL EXPENDITURE	**100%**	**100%**	**100%**

Sources: Budget Execution Report, MoF

Subsection 2.3: Description of the Legal and Institutional Framework for PFM

Legal and regulatory Framework for PFM

17. The current legal framework for PFM in Mongolia is set out in the following box:

Box 1: Legal framework for public financial management in Mongolia

The Fiscal Stability law (FSL, 2010): The Fiscal Stability Law (FSL) introduces four fiscal rules to deal with mineral price volatility and Dutch disease effects. First, it mandates that structural or long term mineral prices be used to calculate structural budget revenues. Second, the annual structural budget deficit (expenditure minus structural revenues) should be below 2 percent of GDP. Third, the annual growth of government expenditure shall not exceed non-mineral GDP growth as another safeguard measure to curb excessive spending growth. Fourth, to maintain long-term fiscal solvency, the public debt-to-GDP ratio will be maintained at below 40 percent from 2014. All revenues in excess of structural revenues are saved in the Fiscal Stability Fund, which shall be not less than 5 percent of GDP in any given year. The law went into effect January 2013.

The Budget Law (IBL, 2011): The integrated Budget Law of Mongolia (IBL), which went into effect in January 2012, is the primary budget legislation for the country that replaced the Public Sector Management and Finance Law (PSMFL) and the General Budget Law of 1992. The main objectives of the IBL are to: (i) strengthen the medium term fiscal framework (MTFF) and ensure fiscal stability; (ii) improve the comprehensiveness of the budget; (iii) strengthen the public investment planning and capital budgeting process; (iv) ensure efficient financial management; (v) significantly increase the authorities and financial resources of local governments; and (vi) strengthen accountability through participatory budgeting.

The law states that the budget consists of the state (central government) budget, local government budget, the Human Development Fund, and the Social Insurance Fund. The budget should list projects to be executed through concessions contracts and includes information on government guarantees and contingent liabilities, thereby improving the budget's comprehensiveness. The budget calendar is laid out in detail with the process commencing with the approval of the MTFF by the Parliament by June 1, together with the Socio-economic Guidelines, which forms the basis for the budget ceilings of line ministries. Budget proposals from line ministries and the National Development and Innovation Committee (NDIC, currently the Ministry of Economic Development) for large projects, as discussed below, are meant to comply within the limits imposed by these ceilings. This provision should significantly improve the credibility of the budget process.

The IBL envisioned to significantly strengthen public investment planning and capital budgeting process, thereby redressing a major weakness in the PSMFL. It mandates that only projects that have gone through a proper appraisal process will be considered for financing from the budget. The IBL also introduces the concept of a four-year rolling Public Investment Program (PIP) for large projects and mandates that the recurrent cost implications of capital projects be included in budget proposals.

The authorities of local governments have been significantly enhanced, with the capital city and aimag governments responsible for basic education, primary healthcare, urban planning and construction, social welfare services, water supply and sewerage, public transport, urban roads and bridges, and municipal services such as street lighting and garbage removal. These functions will be financed through local taxes and fiscal transfers (an equalization grant) from shared taxes from the central government, with the transfer formula based on the size of population, population density, remoteness and the size of the local government, and the level of local development. There is also a conditional performance element to the transfers that are linked to local tax effort. Only the capital city government is allowed, with the approval of the MoF, to borrow from capital markets to finance public investment projects, with their debt size limited to the previous year's revenue and debt service limited to 15% of the previous year's revenue.

The Public Procurement Law of Mongolia (PPLM, 2011): The PPLM went into effect in January 2013. The law introduced radical changes in the system for public procurement in Mongolia. It brought the procurement responsibility from line ministries and to a new Government Procurement Agency (GPA) for national level projects and to local governments for local level projects. The GPA became responsible for all procurements of large projects — such as inter-regional roads and power plants — as well as for establishing framework agreements for common use items (such as office supplies) that will be purchased by line ministries. Local governments will be responsible for all procurements of works, goods, and services to be financed from the local budget, as well as for local projects (e.g. schools and hospitals) financed from the national budget. One of the most important aspects of the revised law is the new role for civil society organizations in both bid evaluation and contract monitoring. Monitoring of contracts by civil society organizations potentially covers both monitoring of the implementation of on-going contracts as well as gauging end-users' satisfaction with completed contracts.

General Taxation Law (2008): establishes the legal basis for creation of new taxes, tax imposition, reporting, payment, inspection and collection, defines rights, responsibilities and functions of the tax administration and regulates their relations with around 18 other tax laws. More specifically, the General Taxation Law is the umbrella law which regulates the types of taxes, taxable items, rate, tax holidays and exemptions, rights and responsibilities of tax inspectors and taxpayers, tax administration units' services to the taxpayers, structure and functions of the tax authority and tax inspectors, status and operation of the general database for tax information and recording, tax inspection process and dispute resolution mechanisms.

Any changes to the tax legislation are initiated by a relevant government organization in charge of tax policy and associated formal decisions are endorsed by parliament. The Government submits to the Parliament any amendments of the general tax law and other tax regulations together with annual budget proposal. According to the tax legislation, Mongolia has flat 10% tax regime for major income taxes such as PIT and VAT and two-stage tariff for CIT: 10% for up to 3 billion tugrugs of income and 20% for above than 3 billion tugrugs.

The Law on State Audit (LSA, 2003 with latest amendments made in 2013): Following the decentralization of budget accountability to the local municipal authorities, as introduced by the IBL, the LSA of Mongolia was amended in 2013 to shift the country's Supreme Audit Institution – the Mongolian National Audit Office (MNAO) – to a vertical organizational structure, which requires local state audit branches to report to the Auditor-General of Mongolia instead of reporting to the local municipal authorities as previously mandated. By amending the LSA, state auditors are now responsible for reviewing not only the budget execution but also compliance with Parliament-approved legislation and implementation of recommendations provided by Standing Committees and other institutions in the Parliament structure. The vertical organizational structure will also allow the government auditors at all levels to receive their operational direction and guidance from the Auditor-General and report back to a central organization. The law and the latest amendments to it have been in effect since January 3, 2003 and November 7, 2013, respectively.

The institutional features for PFM

18. The main institutions for PFM, with their roles and responsibilities, are set out in the above-mentioned laws and include: the Ministry of Finance (MOF), the Ministry of Economic Development (MED), the Mongolia National Audit Office, the Mongolian Tax Authority, the Mongolian Customs Authority and the State Great Khural (Parliament).

The State Great Khural (Parliament): The parliament is responsible for approving all legislative acts and laws including the MTFF (medium term fiscal framework), the medium-term and annual strategic plans, the annual budget, the audited budget execution reports, tax laws, and to oversee the spending and results from public funds. The parliament has the authority to amend the approved annual budget law, endorse any tax rate related changes.

The Ministry of Finance (MOF): The MOF is the main central government agency in charge of formulating fiscal policy, preparing, implementing, and reporting on the annual budget, ensuring timely financing of public funds and the revenue generation process. Its organizational chart is provided in Figure 1 below. The Fiscal Policy and Planning department is responsible for the drafting annual budget, preparing medium term fiscal framework and implementing the annual budget law while department of Financial Policy and Debt Management is in charge of management and reporting of the state debt. In terms of the fiscal revenue, the MOF is the institution that proposes any changes in tax rates, exemptions and tax holidays on behalf of the government. Tax revenue is collected through two main separate agencies – the General Department of Taxation and the General Department of Customs – under the MoF. Through its Treasury Department, the MOF handles expenditure transactions for the other central government line ministries, agencies, local governments and special government funds such as Social Insurance Fund and the Human Development Fund. Until September 2012, MoF was also responsible for public investment planning and the preparation of the capital budget; this function then shifted to the Ministry of Economic development (MED). The MOF continues to be responsible for capital expenditure transactions.

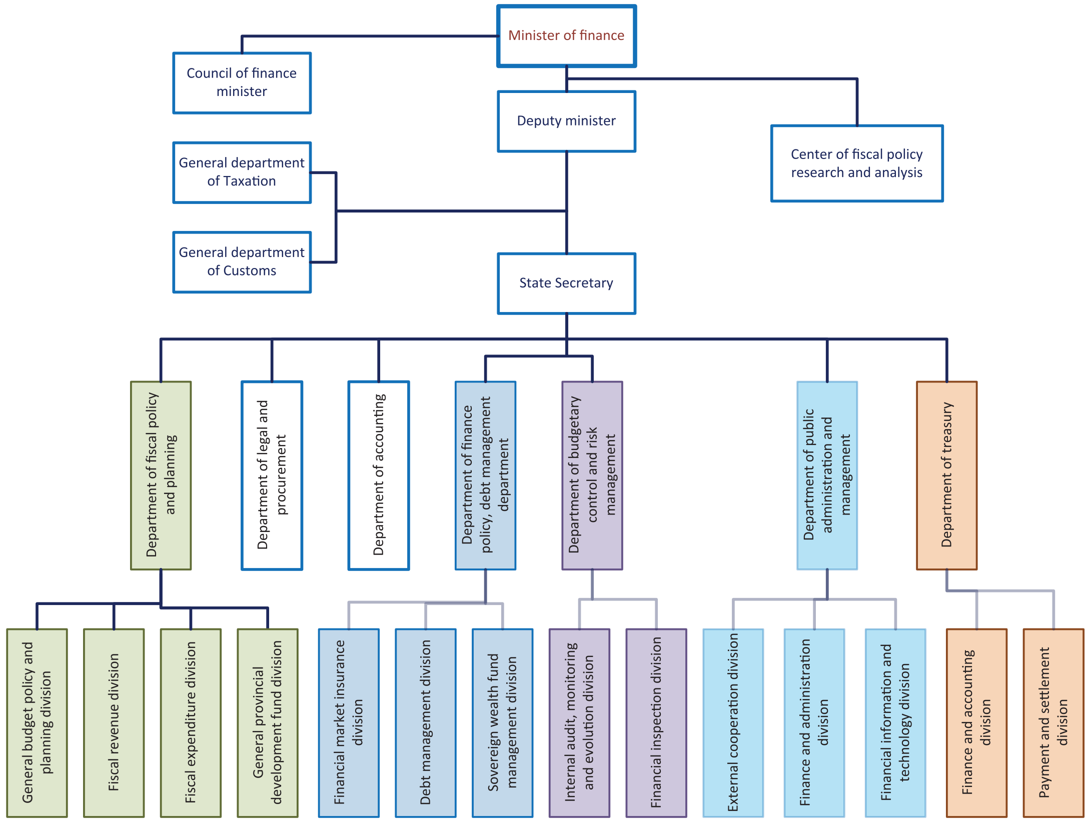
The Ministry of Economic Development (MED): The MED is a central government body that defines annual and medium term socio-economic policy, excercises government's external borrowing authority and develops planning of large scale investment projects. The MED plays an important role in overall public finance practice due to its external borrowing function and supervision of the Development Bank of Mongolia which has been the largest off-budget vehicle for investment financing since 2012. The MED is in charge of negotiating and signing in international borrowing agreements on behalf of the government while the MOF takes care of the actual financing of the lending projects.

General Department of Taxation (GDT): Mongolian taxation authority is the government execution agency in charge of tax revenue collection and it directly reports to the Ministry of Finance according to the IBL and General Taxation Law. The GDNT has vertical structure and therefore consists of the district and local tax offices according to the General Taxation Law. Tax revenues transferred to the GDNT account are reconciled on daily basis and transferred to the Treasury Single Account at the MOF.

The Mongolian Customs Authority: The Customs Authority is another government executing agency in charge of trade facilitation and collecting customs tax and duties for imports and exports. The customs tax rates and fees are regulated by the relevant tax laws. The customs authority reports to the ministry of finance.

The Mongolia National Audit Office (MNAO): The state audit board is the supreme audit institution that conducts audits for public financial operations including annual budget, government financial statement, effectiveness and efficiency of using public funds for various stated purposes. According to the IBL, the annual government financial statement has to be audited and the audited statement has to be approved by parliament.

Figure 1. The organization structure of the ministry of Finance



Section 3: Evaluation of PFM systems, processes and institutions

Subsection 3.1: Budget Credibility

19. A credible budget — one where actual budget outturns are in line with the fiscal planning envisioned at the budget preparation stage — is necessary for sound fiscal management and to provide a stable environment for the delivery of services and public goods by line ministries and implementing agencies. This section measures the credibility of the budget of the budgetary central government using four indicators (from PI-1 to PI-4) comprising key budget execution parameters: (a) deviations in aggregate expenditure, (b) deviations in expenditure composition, (c) deviations in total budget revenue, and (d) stock and monitoring of expenditure payment arrears. Budgetary central government excludes the Human Development Fund (HDF), Social Insurance Fund (SIF), the Development Bank of Mongolia (DBM), and the Local Government Budget as per the PEFA guidelines. Primary budgetary central government expenditure data have been used for PI-1 and PI-2 which measure expenditure outturns[6]. PI-3, the revenue indicator, excludes grants and loans. All the data are from audited government financial statements and the accounting is on a cash basis.

PI-1 Aggregate actual expenditures compared to the original approved budget

20. Table 7 shows the outturn of the aggregate primary expenditure in 2011-2013 compared to the original approved budget during the same period. Deviations of the actual primary expenditure from the original budget were 28.8 percent, -18.1 percent, and -19.2 percent in the last three years respectively.

6 Primary expenditures include both recurrent and capital expenditures. They exclude debt service charges and donor-financed project expenditure (loans and grants).

Table 7: Aggregate expenditure out-turn compared to original approved budget: Central Government Budget (in billions of Togrogs)

	2011	2012	2013
Budgeted primary expenditures (1)	2,637.1	4,489.7	5,125.2
Actual primary expenditures (2)	3,396.5	3,676.1	4,138.9
Difference (3)=(1)-(2)	759.4	-813.6	-986.3
Overall variance: (3)/(1)	**28.8%**	**-18.1%**	**-19.2%**

Source: Budget Execution Report, MoF, World Bank staff estimates

Note: Primary expenditures exclude donor funded projects and interest payments from the total expenditure of the budgetary central government.

21. These relatively large deviations in budget execution were mainly due to inaccurate revenue forecasts, as detailed under PI-3. As a result the budgets were amended mid-year in each of the year to make the necessary adjustments to spending to abide by fiscal rules in the FSL. In 2011 the original budget reflected conservative mineral revenue projections; as actual revenue outturn came higher the budget was amended mid-year to increase expenditures on wages, subsidies, and social transfers (in particular adding MNT 21,000 cash transfer to every citizen out of human development fund (HDF) and tuition fee support to students). In 2012 and 2013, the original budget was based on overly optimistic revenue forecasts, which led to an unrealistically ambitious expenditure plan particularly with regards to the capital budget. The adjustments in the amended budgets were primarily through reductions in capital spending. For example, in 2013 the amended budget passed by the Parliament in November reduced expenditures by 10.9 percent (MNT 814 billion) to adjust to the revenue shortfall, with current and capital spending cut by MNT 234 billion and MNT 620 billion respectively. However, a bulk of capital expenditure – which was carried out through the DBM – remained outside the official budget.

Indicator	Score	Explanation	Information sources
PI-1 Aggregate expenditure outturn compared to original approved budget	D	**M1 Scoring Method**	
(i) The difference between actual primary expenditure and the originally budgeted primary expenditure	D	The deviations in percent to original budgeted expenditure were -28.8%, -18.1% and -19.2% in 2011, 2012 and 2013 respectively. Therefore, in each of the last 3 years actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure.	Calculation for budget outturns is based on the budget data available on (www. Iltod.gov.mn)

PI-2 Composition of actual expenditures compared to the original approved budget

22. This indicator compares primary expenditure, budgeted and actual, at a sub-aggregate level across the main administrative headings. The first dimension measures the extent to which reallocations between budget heads during execution have contributed to variance in expenditure composition without taking the contingency vote into consideration.[7] The use of a contingency vote is considered in the second dimension.

[7] As per the PEFA guidelines, adjusted expenditures for individual budget heads were calculated based on the percentage share of aggregate actual expenditure to aggregate budgeted expenditure and the differences (deviations) between actual expenditure and

(i): Extent of variance in expenditure composition during the last three years, excluding contingency items.

23. Table 8 provides details of the variation in the composition of expenditures for the 20 largest budget heads of the budgetary central government, with the remaining budget heads consolidated into a single "others" category. The aggregate deviations were 14.3 percent, 13.2 percent, and 25.8 percent respectively in the last three years. These results indicate that the large variation in aggregate expenditure outturn is translated into the weak and unpredictable delivery of services in individual budget heads.

Table 8: Variance in expenditure composition excluding contingency item

№		2011			2012			2013		
		Adjusted budget	Actual expenditure	Absolute value of deviation	Adjusted budget	Actual expenditure	Absolute value of deviation	Adjusted budget	Actual exp.	Absolute value of deviation
1	Minister of Education, Culture & Science	764.3	646.6	117.7	952.3	1012.0	59.7	1328.3	1050.0	278.2
2	Minister of Social Welfare & Labor	609.0	785.7	176.7	230.6	244.0	13.4	418.6	557.5	139.0
3	Minister of Road, Transport, Construction & Urban Development	303.2	305.5	2.3	609.7	447.5	162.3	489.5	329.8	159.7
4	Minister of Health	358.1	321.3	36.8	419.4	424.6	5.2	399.9	415.8	15.9
5	Minister of Finance	164.3	158.6	5.7	169.0	206.0	37.0	336.1	451.1	115.0
6	Minister of Justice	246.1	235.9	10.2	257.1	316.1	59.1	238.9	348.6	109.6
7	Minister of Food, Agriculture & Light Industry	197.9	215.6	17.7	165.7	113.1	52.7	194.5	144.8	49.7
8	Minister of Fuel & Energy	148.5	168.2	19.7	204.1	189.9	14.2	131.2	146.2	15.0
9	Minister of Defense	128.3	106.4	21.9	140.8	154.3	13.5	118.5	157.7	39.2
10	Minister of Environment & Tourism	80.3	88.0	7.7	90.5	84.3	6.1	82.4	70.9	11.5
11	Deputy Premier of Mongolia	78.0	82.5	4.5	84.1	87.2	3.1	82.8	110.6	27.8
12	Prime Minister of Mongolia	44.9	51.3	6.5	82.9	108.0	25.1	109.7	146.5	36.8
13	Minister of Foreign Affiars	40.5	36.9	3.6	35.9	39.9	4.0	36.9	52.4	15.5
14	General Election Committee	30.2	24.2	6.0	17.6	21.1	3.5	12.3	12.1	0.2
15	Cabinet Secretariat	26.6	25.5	1.1	46.3	44.8	1.4	19.0	22.8	3.8
16	Speaker of The Parliament	15.5	-8.3	23.8	15.6	15.0	0.5	12.1	13.7	1.6
17	General Court Committee	14.7	13.2	1.6	17.3	20.3	3.0	42.0	42.3	0.3
18	State General Prosecutor	10.5	10.3	0.1	15.8	18.3	2.5	25.0	23.7	1.3
19	Minister of Economic Development	7.3	5.6	1.7	12.6	15.6	2.9	48.3	15.0	33.4
20	Office of The President	4.8	4.3	0.5	5.5	5.8	0.3	8.2	7.3	0.9
21	Others	22.1	17.6	4.5	22.5	27.6	5.0	15.4	30.9	15.5
	Total expenditure	3295.0	3295.0	470.4	3595.5	3595.5	474.4	4149.8	4149.8	1069.8
	Sum of absolute values of deviations	**470.4**			**474.4**			**1069.8**		
	% deviation from total adjusted budget expenditure	**14.3%**			**13.2%**			**25.8%**		

1/ Expenditures exclude debt service, donor funded projects, and contingency items as per the PEFA guideline.
2/ Expenditures for individual budget heads were grouped to account for government restructuring in 2012.
3/ The small discrepancy between the actual expenditures in this table and the actual expenditures in Table 7 is due to government reorganization that split and merged several ministries that is resulting in some double counting.

adjusted budget expenditure were calculated for the individual budget heads. Finally, the sum of absolute values of expenditure deviations from each budget head was computed and its percentage share to total aggregate adjusted budget was used to assess this dimension of the PI-2 indicator.

(ii) Average amount of expenditures actually charged to the contingency reserve over the last three years.

24. The MoF maintains two types of contingency funds: the Government Reserve Fund and the Contingency Fund. The Law on Government Special Fund specifies the purpose of these two funds. The Government Reserve Fund is to be used for relief expenditures due to natural or man-made disasters, implementation of new legislation, government expenses in international dispute resolution, and expenditures related with international treaties. The Contingency Fund is to be used for unexpected large revenue shortfalls, disruption in domestic production and services including agricultural production due to unforeseeable events or natural disasters, abrupt fluctuation in exchange rates, and abrupt price increases of flour, wheat and petroleum products in domestic markets. The actual use of these contingency funds was 1.3 percent, 0.7 percent, and 0.4 percent in of the total budgeted primary expenditures in the last three years (Table 9).

Table 9: Actual use of contingency reserve in percent to total budgeted primary expenditure
(in billions of MNT)

	2011	2012	2013
Government Reserve Fund (1)	28.3	26.7	18.7
Contingency Fund (2)	5	5.6	0.5
Expenditures Charged to Contingency Votes (3)	33.3	32.3	19.2
Total Budgeted Primary Expenditure (4)	2,637.1	4,489.7	5,125.2
(3)/(4)	1.3%	0.7%	0.4%

Indicator	Score	Explanation	Information sources
PI-2 Composition of expenditure outturn compared to original approved budget	**C+**	**M1 Scoring Method**	
(i) Extent of the variance in expenditure composition during the last three years, excluding contingency items	C	Variance was: 14.3% in 2011; 13.2% in 2012; and 25.8% in 2013. Therefore, variance in expenditure composition exceeded 15% in one of the last three years.	Calculation for budget outturns is based on the budget data available on (www.Iltod.gov.mn); NSO monthly bulletin
(ii) The average amount of expenditure actually charged to the contingency vote over the last three years	A	The actual expenditure charged to contingency funds was 1.3% in 2011, 0.7% in 2012, and 0.4% in 2013, and therefore less than 3 percent of the original approved budget in each of the three years	As above

PI-3 Total actual revenue compared to the original approved budget

25. Accurate revenue forecast is a key input to the preparation of a credible budget as the budget expenditure will likely be largely affected by especially under-realization of revenue. This indicator measures actual domestic revenue (which includes foreign grant) collected compared to the revenue projections in the original approved budget.

26. Table 10 shows that there were significant deviations in actual outturns as compared to the originally approved budget. In the three years under review (2011-2013), domestic revenue outturn for the budgetary central government was 125.6%, 69.8% and 88.1% of the domestic budget revenue originally approved by Parliament, respectively.

27. There are technical and political reasons for the inaccurate revenue forecasts. Mineral prices had been consistently under-estimated during the global commodity boom over the past decade. In 2011 for example, total annual revenues were 25.6 percent higher in nominal terms, driven mainly by unexpected increase in receipts from royalties and dividends reflecting the inherent difficulty of making projections for such volatile mineral prices. The revenue projection function lies in the Tax Revenue Division of the MoF, and the MoF bases its projections from revenue estimates of line ministries (e.g., Ministry of Mining for mineral revenue projection), local governments, the General Department of Taxation, and the Customs Authority. There are inaccuracies in the source data from these agencies, but also weaknesses in the process of consolidation in MoF, and in the macroeconomic assumptions prepared by the Ministry of Economic Development that underpin additional forecasts.

28. Political factors have played a bigger role since 2012 as the Government overestimated revenues despite the weakening minerals market. Overestimation of revenues came largely to meet increasing demands to finance its rapidly expanding capital expenditure plans (funded by the budget and extra-budgetary funds). The budgets were prepared with overly optimistic assumptions of GDP growth, inflation, import growth, privatization revenues, tax prepayments etc., which did not sufficiently take into account the vulnerable global economic environment with slowing growth in China (Mongolia's main market for mineral exports) and weaker global commodity prices. As a result, mining sector receipts (CIT, dividends, VAT on imported equipment) had been much weaker than anticipated in 2012 and 2013.

Table 10: Variation in domestic revenue: Budgetary Central Government

(in billions of MNT)

	2011	2012	2013
Total Budget Revenue	2,675.4	4,953.1	4,606.4
Foreign Grants	8.6	-	-
Total domestic revenue (1)	2,666.8	4,953.1	4,606.4
Actual Revenue	3351.4	3481.2	4057.3
Actual Foreign Grants	1.50	24.7	-
Actual Domestic Revenue (2)	3,349.9	3,456.5	4,057.3
(2)/(1)	125.6%	69.8%	88.1%

Source: World Bank staff estimates based on the budget data of the MoF

Indicator	Score	Explanation	Information sources
PI-3 Aggregate revenue outturn compared to original approved budget	D	**M1 Scoring Method**	
Actual domestic revenue compared to domestic revenue in the originally approved budget	D	Actual domestic revenue collection was 125.6% in 2011, 69.8% in 2012, and 88.1% in 2013 of budgeted revenue respectively. Actual domestic revenue was therefore below 92% or above 116% of budgeted domestic revenue in all the last three years.	Calculation for budget outturns is based on the budget data available on (www. Iltod.gov.mn)

PI-4 Stock and monitoring of expenditure payment arrears

(i) Stock of expenditure payment arrears

29. Arrears have not been an issue for recurrent spending as the MoF exercises strong control on the monthly allotment of the budget and payments through the GFMIS. The stock of payment arrears has however, increased for capital expenditures with the growth of government spending and the shortfall in government revenue collections as compared to the original budget. This problem was particularly evident in 2013 due to the revenue shortfall and the capital budget was significantly under-executed (65% actual spending as compared to the budget), in part due to the deferment of payment of 183 billion MNT to contractors. By contrast, capital arrears for 2012 were negligible.

30. As Table 11 details, the total stock of expenditure arrears at the end of 2013 was 3.9 percent of total expenditures, a significant increase from 0.001 percent in 2012. It therefore constitutes between 2-10% of total expenditures, and has not been reduced over the last two years, resulting in a score of C for this dimension.

Table 11: Expenditure Arrears (in millions of MNT), Budgetary Central Government

	2012	2013
Recurrent expenditure arrears	64.1	63.5
Of which, 0-60 days overdue	61.9	59.7
61-120 days overdue	0.5	2.8
More than 120 days overdue	1.7	1.0
Capital expenditure arrears	0	183,000
Total arrears	64.1	183,064
Total expenditures	4,379,479	4,683,038
Arrears as percentage of total expenditures	**0.001%**	**3.9%**

(ii) Availability of data to monitor the stock of expenditure payment arrears

31. The reporting requirement for arrears varies for recurrent and capital expenditures. For the former, all budget entities are required to produce monthly reports on arrears to the Treasury Department. At the end of the fiscal year a consolidated report is produced by the Treasury Department with the data broken down by economic classification and the duration of the arrears (less than two months overdue, up to 4 months, and more than 3 months). For the latter, the reporting is handled by the Fiscal Policy and Planning Department, with only the level of arrears calculated and no age profile information. The assessment team received copies of the 2012 and 2013 reports, which was used to prepare Table 11 above.

Indicator	Score	Explanation	Information sources
PI-4 Stock and Monitoring of expenditure payment arrears	**C**	**M1 Scoring Method**	
(i) Stock of expenditure payment arrears	C	The stock of expenditure arrears constitutes 3.9% of total expenditures. Arrears have increased over the last two years.	MoF Payment arrears reports received from the Treasury Department and the Fiscal Policy and Planning Department
(ii) Availability of data in order to monitor the stock of expenditure payment arrears	C	Data for the stock of arrears is generated annually, but is only complete for recurrent expenditures.	As above

Subsection 3.2: Comprehensiveness and Transparency

PI-5 Classification of the Budget

i) The classification system used to formulate, execute and report on the central government budget.

32. According to the IBL, budget planning, budget execution and budget reporting should be classified by:

a) Budget level[8];
b) Budget governors[9];
c) Economic classification;
d) Programs;
e) Activities;
f) Financing sources.

33. For the last completed fiscal year (2013), budget planning (preparation) was classified by administrative, functional (10 functions as per the UN-supported Classification of Functions of Government (COFOG)), program, and economic classification (broadly compliant with Government Finance Statistics (GFS) 86). Budget execution and budget reporting however, were carried out only according to administrative and economic classification and based on a chart of accounts that is not fully consistent with GFS and is different from the classification used for budget preparation. The execution chart of accounts includes administrative and economic classification, but at a very detailed classification level so that the GFMIS system cannot be used to produce budget execution reports. As a result, the reports which are generated from the system need to be re-arranged using bridging tables to prepare monthly budget execution reports for the purposes of budget management. This manual data conversion results in additional work and potential data entry errors. There are procedures in place to ensure that the reports are generally accurate.

34. The IMF and WB are currently assisting the Ministry of Finance to harmonize the chart of accounts so that budget planning, execution, and reporting can be based on the same standard.

Indicator	Score	Explanation	Information sources
PI-5 Classification of the Budget	C	**M1 Scoring Method**	
(i) The classification system used to formulate, execute and report on the central government budget	C	The budget formulation, execution and reporting is based on administrative and economic classification using GFS standards.	Law of Mongolia, Budget Law, December 23rd, 2011; MOF, Budget Classification Document (2013); Budget for FY 2013; IMF, Report by Arun Kumar Srivastava (November 2013); IMF, Mongolia-Staff Report for the 2013 Art. IV Consultation, November 5, 2013

8 Central Government, Local Government, Human Development Fund and Social Insurance Fund.
9 Means general, central and direct budget governors

PI-6 Comprehensiveness of information included in the budget

35. The IBL (Articles 32) specifies the information that needs to be submitted in the budget documentation as per the budget calendar elaborated under PI-11. Overall, the annual budget package submitted to the parliament includes 8 out of the 9 elements required under the PEFA framework. This documentation is detailed in the Table 12 below:

Table 12: Information contained in Mongolia's budget documentation

#	Elements to be included in the budget documentation	Status	Notes
1	Macroeconomic assumptions, including at least estimates of aggregate growth, inflation and exchange rate	Yes	Macroeconomic assumptions include: GDP growth, inflation, exchange rate, exports and imports, prices of key commodities, revenue and expenditure projections.
2	Fiscal deficit, defined according to GFS or other internationally recognized standard.	Yes	The Government prepares its annual budget proposal according to the GFS classification. Three types of fiscal deficit are calculated: overall, current, and structural (based on long-term mineral prices, as per the requirements of the Fiscal Stability Law).
3	Deficit financing, describing anticipated composition.	Yes	Deficit financing is presented in the budget proposal as a below-the-line item as required by Article 32.2.16 of the IBL and consists of the following financing items: net changes of cash flows, government treasury bills, government external and internal borrowings, privatization proceeds, and advance payments, if any.
4	Debt stock, including details at least for the beginning of the current year	Yes	Total debt stock is estimated in net present value terms (as required in the FSL) and includes: the end year actuals for the prior year, planned and approved amount for the current year, plus the estimations for budget year.
5	Financial assets including details at least for the beginning of the current year	No	
6	Prior year's budget outturn, presented in the same format as the budget proposal.	Yes	The budget proposal presents the prior years' actuals in the same format as the budget proposal.
7	Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.	Yes	Current year's budget, (either the approved or the amended plan) and the current year's outturn for the first 3 quarters are presented in the same format as the budget proposal.
8	Summarized budget data for both revenue and expenditure according to the main heads of the classification used (ref. PI-5), including data for the current and previous year.	Yes	The General Balance Table of the budget proposal presents the summarized budget data for both revenue and expenditure according to the main heads of the classification used including the previous five years actual performances, current year approved or amended estimates and outturns.
9	Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.	Yes	As required under the IBL, the budget package document submitted to the parliament introduces key policy measures on revenue and expenditure side, presents their fiscal costs and impact, coverage and scope.

Indicator	Score	Explanation	Information sources
PI-6 Comprehensiveness of information included in the budget	**A**	**M1 scoring method**	
Share of the listed information in the budget documentation most recently issued by the central government	A	Recent budget documentation fulfils 7-9 of the 9 information benchmarks	IBL 2011; 2014 Budget

PI-7 Extent of unreported government operations

(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports

36. The scale of extra-budgetary financing of government capital expenditures has increased rapidly since 2012 and consists primarily of capital projects financed by the DBM and quasi-fiscal operations of the Bank of Mongolia. This section analyzes only the extra-budgetary expenditures financed by the DBM for which accurate data is available, which are significant but underestimate the actual off-budget spending.

37. The DBM, which is regulated by the Law on Development Bank of Mongolia, has been financing projects out of three sources: own capital, a US$ 580 million midterm euro bond, and a US$ 1.5 billion sovereign bond (the Chinggis bond), all of which are 100% guaranteed by the Government. In addition to these funding sources, the DBM issued a samurai bond with a 10 year maturity at 1.52% coupon rate in late 2013. The DBM loans are classified into two types of operations: (i) loans to be repaid by the state budget and (ii) loans that are supposed to be repaid by the revenue stream of projects that are financed by the DBM. Projects of the first type that are financed are regarded as "social projects" that include construction of roads, street renovation, power station and railway projects. These are government budget operations and are implemented by the responsible line ministries. DBM will almost certainly call the government guarantee when the debt repayments are due. Projects of the second type include loans that were issued mostly to private sector recipients including transportation, mining and housing construction sectors. These projects are deemed bankable by the government as recipients of these loans are supposed to be able to generate sufficient financial revenue streams.

38. At the end of 2013, over 60 percent of total outstanding loans from the DBM were issued to social projects implemented by line ministries and constitute extra-budgetary funding of central government operations. These social projects amounted to 1.5 trillion MNT, or 8 percent of GDP and 28 percent of total central government expenditures (and 19.7 percent of general government expenditures) and were roughly equivalent to official budget capital expenditures. This capital expenditure financed by the DBM is not included in the medium-term fiscal framework, budget estimates or the in-year budget execution reports. As a 100 percent state-owned entity, and as required by its own law, the DBM does get its annual financial statements audited and consolidated at the end of the fiscal year together with the financial reports of other public enterprises, and these consolidated financial statements are then presented to parliament.

(ii) Income/expenditure information on donor-financed projects which is included in fiscal reports

39. The Government has comprehensive information on loan-financed projects and this information is included in the budget documentation; however, it has limited information on grant-financed projects and most of these projects are not included in fiscal reports.

40. Information about donor-funded projects is handled by two ministries: Ministry of Economic Development (MED) and Ministry of Finance (MoF). MED is mandated to sign and approve loans and grants; MoF is responsible for processing the expenditures of loans and grant funds, recording the information, and including the information in the budget. Recording of loan-funded projects is comprehensive, with income and expenditure information included in the annual budget and government financial statements, as required by the Law on Coordination and Management of Foreign Aid. Grants from larger donors such as WB, ADB, UN, USAID, JICA and KOICA are approved by the MED; however these grants are not recorded in the budget. The MED and MoF also have no information about the grants from other smaller bilateral agencies, international NGOs and religious organizations.

Indicator	Score	Explanation	Information sources
PI-7 Extent of unreported government operations	**D+**	**M1 scoring method**	
The level of extra-budgetary expenditure (other than donor funded projects) that is unreported i.e. not included in fiscal reports	D	The level of unreported extra-budgetary expenditure — DBM financed capital projects — constitutes 28% of total central government expenditures	DBM; Budget documents
Information on donor-financed projects which is included in fiscal reports	C	Complete income/expenditure for all loan financed projects is included in fiscal reports; however, no information on grants is included	Budget documents, Law on Coordination and Management of Foreign Aid

PI-8 Transparency of inter-governmental fiscal relations

41. Mongolia undertook major fiscal decentralization reforms under the IBL. The country has three levels of sub-national government — aimags (provincial level government) and the capital city (Ulaanbaatar) which has the status of a province, soums (or Districts in Ulaanbaatar) which are sub-units of aimags, and baghs which are sub-units of soums. Aimags and soums have democratically elected parliaments which approve their budgets. Expenditure functions, revenue sources, and inter-governmental transfers are specified by the IBL. The revenue sources of local governments are composed of own source revenue (see table 13 for more details) and inter-governmental transfers. Inter-governmental transfers are provided by the central government budget to local governments in order to finance base budget deficit, to support provision of necessary basic services (e.g., primary health and education), and to support local development.

Table 13: Revenue allocation between state and local governments (IBL)

Common taxes (% share of central Budget : % share of local government)	State taxes (Central government Budget)	Aimag and Capital City taxes	Soum and District taxes
Royalty on minerals (95:5) Domestic VAT (75:25)	CIT VAT of imported goods and services Excise taxes Custom duties Gasoline tax License fees for mining and exploration of mineral resources Air pollution fee Stamp duty (11.2 of the stamp duty law) Water pollution fee	Capital city tax Land user fee Immovable property tax Vehicle tax User fee for water on production use Wage tax (8.1.1 of PIT law) Inheritance and gift tax Stamp duties other than 11.2 of the stamp duty law	PIT other than 8.1.1 of the PIT law Gun tax Stamp duties other than 11.2 of the stamp duty law User fee for hunting License fee for the use of natural resources other than minerals User fee for herbs User fee for timber User fee for common minerals User fee for drinking water and springs Self employment tax Dog tax User charges for waste services

(i) Transparent and rules based systems in the horizontal allocation among sub-national governments of unconditional and conditional transfers from central government

42. Article 56 of the IBL describes three types of inter-governmental transfers: i) state budget financial support to the local governments; ii) special purpose transfers to the local governments for functions that are delegated from the central government to local governments; and iii) state budget transfers to the Local Development Fund (LDF), which is an equalization block grant. Of these three types of transfers, the LDF transfers and special purpose transfers for education and health involved formula-based horizontal allocation mechanisms.

43. State budget financial support is provided to cover the budget deficit of local governments arising from shortfalls in base revenues vis-à-vis base expenditures. Base revenues are defined as the tax and non-tax own-source revenues of local governments. Article 56.4 of the IBL stipulates that estimating base expenditure of each local government shall be decided based on a methodology determined by the central government. This methodology is defined by Government Resolution #30 of 2012, and specifies that base expenditures include fixed costs such as wage and social insurance bills, rent, and cost of electricity and heating, variable costs such as fuel, and certain capital expenditures. The MoF has discretion on how these costs are estimated and financial support cannot be considered formula based.

44. Special purpose transfers to local governments provide earmarked transfer for specific central government services delegated to local governments. Article 61 specifies services to be financed by special purpose transfers as: (i) pre-school and general education services; (ii) cultural services; (iii) primary health care services; (iv) land relations and cadaster services; (v) child development and protection services; (vi) public fitness services. The aimag and soum governors prepare a proposal on the budget for each of the delegated services and submit the proposal to the local parliament of respective levels (the Citizen's Representative Khural). Transfers to education and primary health services are the only special purpose transfers that are based on a formula. The education transfers are a function of number of students, and a unit cost per students which accounts for a variety of factors including the number of teachers per student and operating expenses. The health transfer formula is based on population and a financing tariff of health care centers, which is based on the age distribution of the population and other factors. A new updated formula for horizontal allocation of health transfers is currently being developed jointly by the MoF and the MoH, which is planned to be put into use in 2015.

45. The LDF transfers fund local investment projects and programs, identified through participatory procedures in consultation with citizens through a survey. The LDF vertical and horizontal transfer formula is as follows:

- The vertical allocation is done into the General Local Development Fund (GLDF), an account within the Treasury Single Account, receives revenues from the common taxes specified by the IBL (Article 59) and additional sources, specifically: (i) 25 percent of VAT receipts, (ii) 5 percent of mineral royalty receipts, (iii) grants and donations from domestic NGOs and official foreign aid given for local development fund, (iv) surpluses of local government's basic budget balance (i.e., the difference between base revenue and base expenditure) exceeding the size of base expenditures.
- The revenues collected to the GLDF are then horizontally allocated between aimag and soum governments based on a formula. The Government Resolution #30 issued in September, 2012 approved the methodology to be used in "Transferring revenue from Local Development Single Fund (LDSF) to Local Development Funds (LDF)". The formula consists of 4 variables with equal weights (25 percent): (i) the level of development of aimags as determined by an official Development Index; (ii) the size of population; (iii) population density, remoteness from Ulaanbaatar, and the size of aimag; and (iv) local tax effort based on four sub-indicators related to local revenue initiative. At least 60 percent of transfers allocated from the GLDF to aimags and the capital city should be allocated to lower level governments (soum and district level) based on a formula based on the abovementioned four criteria.

46. Table 14 shows the breakdown of all transfers to local governments for the three types of transfers for 2013. In 2013, total amount of transfers granted to local governments amounted to MNT 1.1 trillion. Of these, 81.2 percent of the transfers are based on transparent and rule-based mechanism, which consists of the LDF transfer (16.7%), and special purpose transfers to education (57%) and health (7.5%).

Table 14: Composition of Transfers to Local Governments (in millions of MNT, 2013 Actual Outturn)

	LDF Transfer	Financial Support for Budget Deficit	Special Purpose Transfer				Total Transfers Amount	% share of rule-based transfers
			Education	Health	Others	Total Special Purpose Transfer		
2013 Expenditure	187,465	155,002	641,933	84,776	56,638	783,347	1,125,814	81.2%
% share of Total Transfers	16.7%	13.8%	57.0%	7.5%	5.0%	69.6%	100.0%	
Rule-based	Yes	No	Yes	Yes	No			

(ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year

47. Sub-national governments are classified as "budget governors" in the IBL (like line ministries and agencies) and follow the budget calendar specified under the law and as discussed in detail under PI-11. For 2013, the MoF issued the budget circular on July 9th, which included the ceilings for the LDF and special purpose transfers to local governments. These estimates were provided well in advance of the local governments' budget deliberations as the aimags submitted their budgets to their local councils (Citizens Representative Khurals) on November 25.

48. Local governments do have sufficient time to be informed on their allocations from central government for the coming year and to develop their annual budget proposal based on reliable information before the start of the budget process. During the Parliament discussion, horizontal allocation of special purpose transfers and LDF transfers are unlikely to be subject to significant changes as these transfers are based

on pre-determined formula, unless the Parliament decides to adjust vertical allocation of these transfers. Financial support to local governments is subject to some changes during the Parliament discussion. In the 2013 budget discussion in parliament, the horizontal allocation of special purpose transfer was largely unchanged. Total size of LDF transfers was increased by 0.8 percent during the Parliament discussion and the increased LDF transfers were proportionally distributed across aimags. Financial support to cover the basic deficit of local governments was reduced by 2.1 percent along with reductions in base expenditures, and this reduction was unevenly distributed across aimags.

(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral allocations.

49. Local budget revenue and expenditure data is collected and reported for general government on a monthly basis. The data on approved annual local budget, monthly plan and actual execution are consolidated according to the same format as the general government budget, which consists of administrative and economic classification (see the detailed discussion under PI-24). As stated under the 8.9.1 of the IBL, general budget governors (including aimag and the capital city governors) should submit monthly budget execution reports to the MoF by the sixth day of each month and the consolidated monthly budget execution report of the general government should be publicly released by the 15th day of each month. The IBL also stipulates that aimag and capital city governors submit their annual budget execution reports and financial statement by the 20th of April to the MoF. The actual dates for the 2013 budget year were as follows: the consolidated budget reports were prepared on a monthly and quarterly basis and were published on the MoF website (www.iltod.gov.mn) on the 8th of each month. The annual budget execution reports and financial statement were submitted on the 10th of April.

Indicator	Score	Explanation	Information sources
PI-8 Transparency of inter-governmental fiscal relations	**A**	**M2 scoring method**	
Transparent and rules-based systems in the horizontal allocation	B	Transfers that are based on transparent and rule-based mechanism accounted for 81.2% of total transfers, or more than 50% but less than 90% of all transfers.	IBL Article 59, Government Resolution #30 (2012)
Timeliness of reliable information to SN governments on their allocations from central government	A	SN governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes	
Extent to which consolidated fiscal data is collected and reported for general government according to sectoral categories	A	Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for 90% (by value) of SN government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.	www.mof.gov.mn

PI-9 Oversight of aggregate fiscal risk from other public sector entities

(i) Extent of central government monitoring of AGAs and PEs

50. The two autonomous agencies, the Human Development Fund and the Social Insurance Fund, are part of the general government budget. The IBL requires that these two funds should submit their monthly execution reports and annual budget execution reports as well as annual financial statements together with the state budget and the local government budget. The quarterly and annual execution reports and financial statements include the financial status of the two funds and outturns of revenues and expenditures, as part of the general government budget.

51. As for the public enterprises, the IBL and Law on Audit require fully (100 percent) state-owned enterprises, and enterprises fully owned by the local governments to have their audited financial statements consolidated into the annual Government financial statements, which is reviewed by the MoF and the Government, and then presented to parliament for discussion and approval. The 2012 Consolidated Financial Statements of the Government covered financial statements of 127 state-owned entities and 164 entities owned by local governments.

52. There is however, no regular monitoring of fiscal risks of state-owned enterprises by the MoF, and no overall fiscal risk assessment is produced based on these consolidated financial statements. There is currently on-going technical assistance from the WB and the IMF to build this capacity for fiscal risks assessments in MoF.

(ii) Extent of central government monitoring of sub-national governments' fiscal position

53. Local governments' fiscal position is regulated under chapter 9 of the IBL. Article 57 mandates that local governments cannot run a fiscal deficit (they can request financing from MoF to meet short-term revenue shortfalls) and are prohibited from incurring debts, or issuing guarantees. The notable exception to this rule is the Ulaanbaatar capital city which is allowed to finance investment projects by issuing debt in the capital markets, but under strict conditions specified in Article 62. These are that: the principle does not exceed the previous years "base revenue"; debt servicing does not exceed 15 percent of base revenue; there are strict limits on what can be used as collateral; the debt can only be issued with the explicit authorization of the MoF; and is publically disclosed.

54. The MoF strictly monitors sub-national governments' fiscal position as part of the budget execution reports. The Ulaanbaatar city government should obtain permission from the MoF and needs to be approved by the national Parliament. To date no debt has been issued by the Ulaanbaatar capital city, and therefore the consolidated overview of the fiscal position consists of the consolidated budget exaction statements that are produced monthly, quarterly and annually. These budget execution reports cover both levels of local governments (aimags and soums).

Indicator	Score	Explanation	Information sources
PI-9 Oversight of aggregate fiscal risk from other public sector entities	*C+*	***M1 scoring method***	
Extent of central government monitoring of AGAs and PEs	C	Monthly, quarterly and annual reports on financial status and budget execution of the HDF and the SIF are prepared as part of the general budget. All public enterprises have their audited financial statements consolidated into the annual Government Financial Statement, which is presented to parliament. However, no consolidated overview of fiscal risks on public enterprises is prepared by the Government.	IBL, budget execution report, Law on Audit
Extent of central government monitoring of SN governments' fiscal position	A	The fiscal position of local governments is monitored quarterly by the MoF as part of the budget execution reports and covers both levels of local governments. No debt incurrence of local governments is possible without permission of the central government.	IBL, budget execution reports. Interviews with MoF staff.

PI-10 Public access to key fiscal information

55. The disclosure of fiscal information is mandated by a number of laws and regulations. Fiscal transparency and participatory budgeting are key principles in the Budget Law (Articles 5 and 6) which requires the disclosure of information on the budget plan, execution, and reporting, and the use of citizen surveys for the participatory preparation of local government capital budgets. The Public Procurement Law of Mongolia similarly mandates the disclosure of procurement information. A law on information transparency and access to information (2011) defines obligations of the state with respect to transparency in three key areas: human resource management (e.g. the requiring the state to announce vacancies in an easily accessible manner); budgeting and accounting (e.g. guidelines and timelines for the publishing of the budget, financial reports, audits, etc.) and the procurement of goods and services (e.g. making bid invitations and documents available in an easily accessible manner, as well as providing information on the selection of the winning bidder). The law also defines what information the state can legitimately request from a citizen, and the rights of the individual in obtaining access to information, along with specific time periods within which the state must respond.

56. As per the budget transparency criteria set by the International Budget Partnership (a non-governmental organization), the Government of Mongolia publishes 6 of 8 key budget documents: (i) the pre-budget statement; (ii) executive budget proposal; (iii) the approved budget; (iv) monthly budget execution reports; (v) end of fiscal year report; and (vi) report of the auditor general. The reports it does not produce or publish are the citizen's budget (not produced) and the mid-year report (produced but not published). Mongolia's score in the International Budget Partnership's Open Budget Index (OBI) improved steadily from 18 in 2006 to 60 in 2010, but has declined to 51 in the 2012 survey on account of less information being disclosed in the above 6 budget reports. This score is still higher than the average score of 43 for all the 100 countries surveyed.

i) Number of the elements regarding public access to information, mentioned in table 3.5 that are used (an element can only be considered for the purposes of this evaluation if it fulfils all the requirements).

Table 15: Indicators of public access to key financial information

Key information	*Situation of public access*
(i) Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature.	***YES***. This is a legal requirement for the draft budget law to be accessible to the public through website Budget Law (2011) Art. 8.4.6. on web site. The 2013 draft budget law was posted on the MOF web site on October 5, 2012 www.mof.gov.mn
(ii) In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.	***YES***. Reports are available on-line monthly (web site of the MOF www.mof.gov.mn) monthly within about 10 days of the end of the month covered. They are also provided in hard copies to institutions that request them.
(iii) Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.	***YES***. The 2012 year-end financial statements (last finalized) were posted on the web site www.audit.mn of the Supreme Audit Institution (National Audit Authority or Board) on June 13, 2013, six days after the audit was completed. The audited statements were also available on the web site of Parliament www.parliament.mn
(iv) External audit reports: All reports on Central Government consolidated operations are made available to the public through appropriate means within six months of completed audit.	***YES.*** Audit reports on the government consolidated operations for 2012 were made available to the Supreme Audit Institution (National Audit Authority or Board) www.audit.mn within six months of completed audits (audit completed in June 2013, posted in October 2013)
(v) Contract awards: Award of all contracts with value above approx. USD 100,000 equiv. is published at least quarterly through appropriate means.	***YES***. Everything above 10 million MNT (approximately US $ 5,700.00) is published on-line www.e-procurement.mn
(vi) Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage (elementary schools or primary health clinics).	***YES.*** Information on resources available to primary service units specifically can be accessed through the web site of the units. It is a legal obligation for the unit to post it on its website. If the unit has no website, the information can be requested to the unit. The law obliges the unit to provide all sorts of information relating to the budget and availability of resources.

Indicator	Score	Explanation	Information sources
PI-10 Public access to key fiscal information	***A***	***M1 Scoring Method***	
Number of elements listed above regarding public access to information that is fulfilled.	A	The Government makes available to the public 6 of the 6 listed types of information	Budget Law (2011) MOF, Ministry of Health, Ministry of Education and Science www.mof.gov.mn www.audit.mn www.parliament.mn www.e-procurement.mn Regulation for enabling transparency of budget and finance (Government Decree approving the regulation of January 18, 2012) General regulation for information transparency (Government Decree approving the regulation of December 14, 2014)

Subsection 3.3: Policy-based Budgeting

PI-11 Orderliness and participation in the annual budget process

(i) Existence and observance of a fixed budget calendar

57. The budget calendar is a legal requirement set in the IBL.[10] It is very detailed and can be summarized as follows:

Table 16: Calendar for the budget preparation process (2014)

Deadline in the law	Activity and actual dates
April 15th, 2013	Presentation of the draft Medium-Term Fiscal Framework (MTFF) to State Great Khural (Legislature). The date was respected.
May 1st, 2013	Presentation of the MTFF to State Great Khural (Legislature). The date was respected.
June 20th, 2013	Draft budget ceilings of general budget governors for 2014 budget prepared, consolidated and presented to Government (Cabinet). The date was respected.
July 1st, 2013	The annual draft budget ceilings were discussed and approved by Government and approved on June 26th, 2013 *Government Resolution ref 228 about approving 2014 fiscal ceilings for General Budget Government (June 26th)*
July 5th, 2013	Circular with approved budget ceilings sent to budget governors (entities of Central Government) on July 9th, 2013
August 15th, 2013	Budget proposals finalized by budget governors (entities)
Sept 15th, 2013	Draft budget law submitted to Government
October 1st, 2013	Government submit draft budget law to the State Great Khural (Legislature)
November 15th, 2013	Budget approved by the legislature

10 Law of Mongolia, Budget Law, 23 December 2011, Art.8

58. The calendar is enforced giving budget governors (the IBL's terminology for ministries, departments, agencies, and local governments) about five (5) weeks to meaningfully complete their budget estimates (from July 9th through August 15th in 2013). It should be noted that six weeks are foreseen in the official calendar for preparing the estimates (July 5th through August 15th)

(ii) Guidance on the preparation of budget submissions

59. There is one circular prepared for both recurrent and capital budget, which includes expenditure ceilings approved by the Government (prior to the circular's distribution to MDA), with separate ceilings for the capital and recurrent budget. The Ministry of Finance has the lead in this process but the Ministry of Economic Development participates in the elaboration of the guidelines for the capital budget. It is a clear and comprehensive document consistent with the MTFF which on paper provides sufficient guidance to budget governors. Budget governors however, do not use this guidance effectively and in general do not abide by the ceilings in preparing their budget estimates which reduces the utility of the ceilings in encouraging prioritization.

(iii) Timely approval of the budget by the Legislature

60. For the last 3 budgets (2012, 2013 & 2014) the budget was approved by the State Great Khural (Legislature) before the beginning of the fiscal year. The exact dates are presented below.

Table 17: Dates for budget approval by the State Great Khural (parliament), 2011-2013

Fiscal Year	Date of Approval
2012	November 30th, 2011
2013	November 8th, 2012
2014	November 15th, 2013

Indicator	Score	Explanation	Information sources
PI-11 Orderliness and participation in the annual budget process	A	**M2 scoring method**	
(i) Existence and observance of a fixed budgetary calendar	B	A clear budget calendar exists but some delays are often experienced in its implementation. For the preparation of the 2014 budget, the actual calendar gave five weeks to the entities to elaborate their estimates.	Budget Law 2011; Government Resolution ref 228 about approving 2014 fiscal ceilings for General Budget Government (June 26, 2013);
(ii) Directives on the preparation of budgetary documents	A	A comprehensive and clear budget circular is issued to budget entities, which reflects ceilings approved by the Government (Cabinet) prior to the circular distribution to the entities.	General Guidelines to prepare 2014 budget proposals for general budget government (July 9, 2013).
(iii) Timely approval of the budget by the Legislature	A	For the last 3 budgets (2012, 2013 & 2014) the budget was always approved prior to the beginning of the fiscal year.	Budget Law of Mongolia for 2012. 2013 & 2014

PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting

(i) Preparation of fiscal forecasts and multi-annual functional allocations

61. The medium term fiscal framework (MTFF) is a legal requirement established by the FSL and the IBL. The former specifies the three fiscal rules that underpin the MTFF — a structural deficit (based on long term mineral prices) of less than 2 percent of GDP, limits to expenditure growth, and a debt ceiling of 40 percent of GDP. The latter specifies the process and calendar for the MTFF and its links to the annual budget. The MTFF is prepared (updated) annually on a rolling basis, and presented to Parliament for approval in April of the year (n) preceding the upcoming fiscal year (n+1). It includes detailed forecasts of fiscal aggregates (revenues and expenditures) on the basis of the main categories of economic classification for the years n+1, n+2 and n+3. It also includes detailed forecasts on the financing of the budget deficit.

62. The MTFF in Mongolia however, is currently more of a routine documentary exercise that is not achieving its objective of providing a hard budget constraint. First, the coverage of the MTFF is limited and does not include off-budget expenditures. As elaborated in PI-7 one of the perverse effects of the FSL has been to encourage the significant growth of off-budget spending which is not subject to the limits of the MTFF. Second, the forecasting of the main fiscal aggregates is weak, in part due to the technical challenges of forecasting volatile mineral revenues, in part due to poor coordination between MoF and MED (which has responsibility for macroeconomic forecasting), and in part due to political pressure to increase expenditures. In particular, the parliament can, and does, increase the revenue forecasts in the MTFF through overly optimistic economic assumptions. Third, the links between subsequent MTFFs and between the MTFF and the annual budget are weak. As Table 18 shows, the second year of a particular MTFF is very different from the estimate used for the first year of a subsequent MTFF. Line ministries consistently ignore their ceilings in the preparation of their budget proposals for year n+1. It is not uncommon for the MTFF aggregates to be revised upwards during the annual parliamentary budget discussions to be in line with an expansionary budget.

Table 18: Comparison of successive MTFFs

MTFF	2011	2012	2013	2014	2015
2011 MTFF					
Total revenue	35.4	35.4	30.3		
Total expenditure	40.4	39.4	32.3		
Total budget bal.	-5	-4	-2		
Real GDP growth	7	8.2	9		
2012 MTFF					
Structural revenue		29.8	27.5	24	
Total expenditure		36.5	29.4	26	
Struc. budget bal.		-6.7	-2	-2	
Real GDP growth		16.6	14.8	15.4	
2013 MTFF					
Structural revenue			39.2	36.7	35.1
Total expenditure			41.2	38.2	33.0
Struc. budget bal.			-2	-1.5	2.1
Real GDP growth			19.0	16.3	11.2

Sources: IMF (2013), MoF

(ii) Scope and frequency of debt sustainability analyses

63. During the three-year period 2011-2013, public (external and domestic) debt sustainability analysis (DSA) was carried out yearly by the IMF, using data provided by the authorities. The results of the exercises were accepted by the Government of Mongolia.

(iii) Existence of sectoral strategies with multi-annual determination of current expenditure and investment costs

64. The Government has a number of national and sectoral planning documents. The national planning documents include National Development Strategy (2007-2015) which sets priorities at a very high level of generalization; the Government Action Plan (2012-2016) which is formulated at the start of a new government's term in office and which has a more detailed formulation of priorities; and the annual Socio-economic Guidelines which are meant to specify the priorities for the year. The IBL also mandates a rolling four year Public Investment Program (PIP), the project version of the action plan. Sector strategies have been prepared by the ministry of roads and transportation, the ministry of health and the ministry of education.

65. The national and sectoral strategies are not reconciled with the MTFF (or formulated within a realistic fiscal envelope) and generally do not have a reasonable costing of investments and recurrent expenditures. The 2014 PIP prepared by MED listed over 12,000 projects at an estimated cost of 50 trillion MNT (or over 300 percent of GDP), and was rejected by the cabinet. The Ministry of Roads and Transportation has prepared strategies for road, marine transport, and auto transport for 2011-2016 that have capital costs but not recurrent costs. Information on costing for these three areas is not detailed. The ministry of health has elaborated a strategic plan for 2012-2016 that is not costed (activities of the plan are costed every year). The ministry of education strategy includes an action plan where the cost of the activities (for each objective is costed). Aggregate cost figures are provided in the action plan without being broken down by year or by sub-activities.

(iv) Links between the investments budget and forward expenditure estimates

66. Budgeting for investment and recurrent expenditure are two separate processes with the former the responsibility of the MED and the latter the responsibility of the MoF. Recurrent cost estimates of capital projects are prepared only sporadically — there are some cases where a line ministry informally interacts with MoF to estimate and include recurrent cost implications of investments. In part due to this budgeting weakness, and in part a result of several years of underfunding maintenance, the state of disrepair of public infrastructure is considerable and noted in assessments by the infrastructure related ministries. The growth in nominal capital repair expenditures (twelve-fold increase since 2003), which includes both periodic maintenance and rehabilitation, has been significantly below the trend in the growth in new investments (thirty-five-fold increase), with the result that the ratio of capital repairs to new investment have, for the most part, been declining since 2007.

67. These actual budgeting practices are a significant departure from the IBL. The IBL requires a unified budget process under the authority of the MoF, albeit with a significant role for MED on the planning and appraisal of large projects (above 30 billion MNT), in recognition of the MoF's lack of capacity to perform this planning function. The IBL also mandates that the future maintenance needs of new capital projects be explicitly included in the project proposals if they are to be considered for financing (Article 29). The MoF has also prepared draft guidelines on how calculate recurrent expenditures for different sectors.

Indicator	Score	Explanation	Information sources
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C**	**M2 scoring method**	
(i) Multi-annual fiscal forecasts and functional allocations	C	Forecast of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis	Fiscal Stability Law (2010) Budget Law (2011) MTBF baseline for 2012-2014 MTBF baseline for 2013-2015 Government Action Plan (2012-2016) MOF, MED www.med.gov.mn
(ii) Scope and frequency of debt sustainability analyses	A	DSA for external and domestic debt was undertaken yearly during the three-year period 2011-2013	IMF, Mongolia-Staff Report for the 2013 Art. IV Consultation, November 5, 2013 IMF, Mongolia-Staff Report for the 2012 Art. IV Consultation and Post Program Monitoring, November 29, 2012 IMF, Mongolia-Staff Report for the 2011 Art. IV Consultation, March 30, 2011 www.imf.org
(iii) Existence of sectoral strategies with cost determination	D	Sector strategies have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure	MOF, MED, Ministry of Education and Science, Ministry of Health, Ministry of Roads and Transportation Government Action Plan (2012-2016) Education Policy, Annex 1 to the Decree no A24 issued by the Ministry of Education and Science (20 September 2012) Action Plan for Education Policy, Annex 2 to the Decree no A24 issued by the Ministry of Education and Science (20 September 2012)
(iv) Links between investment budgets and future expenditure estimates	D	Budgeting for investment and recurrent expenditure are separate process with no recurrent cost estimates being shared	MOF, MED

Subsection 3.4: Predictability and Control in Budget Execution

PI-13 Transparency of taxpayer obligations and liabilities

i) Clarity and comprehensiveness of tax liabilities

68. The adoption of Corporate Income and Personal Income Tax Laws in 1991 and General Law of Taxation in 1993 laid the legal foundation for the establishment of a taxation system in Mongolia. Mongolia has currently 18 taxation laws (including General Law of Taxation) and there are 23 types of taxes and of which 21 taxes are actually being collected. The 21 taxes are regulated by the 18 laws which include the Law on Customs Tariff and Duties that separately regulates customs tax. In addition to the 21 taxes, royalties are imposed on mining sector according to the Minerals Law.

69. The General Taxation Law lays out provisions on types of taxes, taxable incomes, principles on tax discounts and exemptions, taxpayer registration, rights and duties of taxpayers, procedures and requirements for tax administration and tax inspectors, and the processes for tax complaints and appeal mechanisms. The law also provides the structure and functions of the General Department of Taxation (GDT, the revenue authority). Individual laws on domestic taxes further specify tax bases, tax rates, tax liabilities, exemptions or deductions. The GDT collects domestic tax revenues except for customs tax through its vertically structured local and capital city tax offices. The Law on Customs Tariff and Duties provides separate regulation on declaration on customs duties, procedures, responsibilities of state customs inspector, as well as the establishment of Customs Authority (CA) of Mongolia. The CA collects customs tax revenues through border customs offices, capital city, airport and inland customs offices and transfers the revenue directly to the central treasury account at the MOF. The Tax Revenue Division at the MoF is responsible for formulating tax policies and making revenue forecasts while revenue collection is the responsibility of the GDT and the CA.

70. While Mongolia's tax laws provide comprehensive provisions on tax liabilities and procedures, there are areas where the legal provisions are not clear. The definition of taxpayers and taxable income, for example the definition of foreign entities and taxable income for CIT, and definitions on asset classes and transactions in relation to property tax. Lack of detailed and clear definitions of tax bases are likely subject to the discretion of tax inspectors.

71. Mongolia's tax system is based on self-assessment, which applies to Personal Income Tax, Corporate Income Tax, Value-added Tax (VAT), and other minor taxes. Given the self-assessment based system, problems with discretion relate largely to tax audits. As detailed in PI-14, about 25 percent of the annual audits conduced are based on ad hoc criteria where discretion is exercised by the tax authority. Discretionary audits, together with the weaknesses in the dispute resolution system discussed below, is a common complaint from the business community. Ad hoc audits to raise tax revenues were viewed to have increased in 2012 and 2013 as the Government faced a revenue shortfall and pressured the revenue authority to raise collections.

(ii) Taxpayer access to information on tax liabilities and administrative procedures

72. Information with respect to all major tax legislation, related changes, decisions and procedure is publicly available on the websites of the tax authority (www.mta.mn), CA (www.ecustoms.mn) and the Ministry of Finance (www.mof.gov.mn) and is also distributed to the taxpayers through newspapers, and official government publications such as "State Information" brochure. The on-line information system of the GDT and CA websites provide comprehensive information on tax laws including customs regulations, mobile applications and on-line instruction on tax filing process. The CA does have integrated customs database which is linked not only to the border customs offices but also to the regional tax offices which delivers updated information on any changes to customs and tax regulations. The customs authority has introduced customs filing and declaration systems at the cross-border customs offices which simplified the time-consuming administrative process for customs declaration. In addition, other information needed by

taxpayers including templates, forms and detailed procedures are also available on the website. However, taxpayer education through TV or radios is yet to be used broadly. Since the GDT has detailed information on taxpayer registration, the agency uses cell phone numbers and email addresses of taxpayers to disseminate new information on changes to tax legislation and to remind them about the legal deadline for paying and declaring their taxes. The tax authority also has taxpayer service desks in its headquarters and in the district tax offices, as well as hotline services.

(iii) Existence and functioning of a tax appeals mechanism

73. The tax complaint mechanism is specified in Article 19.3 of the General Taxation Law, and consists of two levels of Dispute Resolution Councils (DRCs). The first point of complaint is the DRC at the aimag level; if disputes are not resolved at this level then the taxpayer can take the case to the DRC at the GDT. If complaints are not resolved in the DRCs then the taxpayer has the option to take the case to the administrative courts.

74. There are three main weaknesses in the regulatory framework for tax dispute resolution. First, the DRC is not an independent body but reports to the commissioner of the GDT, who has the authority to override the council's decisions. Second, the membership of the council is heavily skewed to government officials. The GDT DRC is chaired by the Director General of the Fiscal Policy Department of the MoF, and includes representative from the Revenue Division of the MoF, the GDT, the Ministry of Justice, and one civil society organization to represent the citizen. It is unclear what criteria are used to select the CSO. Third, the experts in charge of making and presenting the case to the DRC are all officers from the GDT, which creates a conflict of interest.

75. Given these weakness, the MoF, supported by the World Bank's on-going TA project, has proposed amendments to the General Taxation Law to create an independent dispute resolution body that organizationally does not reside within the GDT. This amendment is currently under discussion.

Indicator	Score	Explanation	Information sources
PI-13 Transparency of taxpayer obligations and liabilities	**C+**	**M2 Scoring Method**	
(i) Clarity and comprehensiveness of tax liabilities	B	Mongolia is a self-assessment based system and tax obligations are clear for most laws, with the exception of VAT. Discretionary powers of the GDT are limited to a proportion of audits	General Taxation Law, Law on Customs, interviews with MoF Revenue Division, GDT Tax Collection Department, and Mongolia National Chamber of Commerce
(ii) Taxpayer access to information on tax liabilities and administrative procedures	A	Taxpayers have easy access to information from the website of the tax authority and customs authority and from public service desks in each of the local tax offices	www.mta.mn
(iii) Existence and functioning of a tax appeals mechanism	C	There is a tax appeals mechanism authorized in law, but has many weaknesses and requires a substantial redesign to be fair and transparent.	General Taxation Law (Article 19.3); consultant report; interviews with GDT and MoF Revenue Division staff.

PI-14 Effectiveness of measures of taxpayer registration and tax assessment

i) Controls in the taxpayer registration system

76. The MTA uses multiple registration systems for the different taxes, these systems are not well integrated either with each other or with other government systems, have problems of data quality, all of which reduce efficiency and transparency of tax administration.

77. There are separate taxpayer registration systems for the different taxes, and in the different tax offices (e.g. desktop systems in the local tax offices). Registries for land, individuals, and businesses are maintained by the General Department for State Registration (GDSR), and GDSR issues an identification number to businesses, which serves as their tax identification number (TIN). Individuals' national identification number serves as their TIN. The tax databases interfaces with these different registries maintained in the GDSR, as well as other databases such as the vehicle registration database at the Ministry of Road and Transportation. The quality of the data in the tax registration systems however is poor, due to non-uniqueness of the TIN (e.g. a business can have multiple TINs), errors in the data in GDSR databases, weaknesses in the interfaces between the tax registration systems and these registries, and excessive use of manual data entry with weak controls.

78. The GDT is currently in the process of developing an integrated Tax Administration Information System (TAIS) that would combine core parts of the tax cycle (registration, returns processing, accounting, payments, refunds, collections, and compliance) for all taxes in a single database and with a new unique TIN. The TAIS is expected to go live in early 2015. A major effort is underway to clean the tax registration data as part of the data migration from these multiple databases to the single database in TAIS. The TAIS should significantly improve the controls in the taxpayer registration system.

ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

79. Penalties for non-compliance with registration and tax declaration are specified in detail in the General Taxation Law (Articles 74 and 75). The administrative sanctions are set in terms of multiples of the monthly minimum wage (currently set at 280,000 togrogs). The schedule of fines is long, given the nature of the tax violation and the type of taxpayer. For example:

- For non-registration by the specified deadline, the fines are the monthly minimum wage for individuals, and 2 to 3 times the minimum wage for a legal entity (e.g. businesses) depending on the size of the entity;
- For non-filing of taxes by the deadline, the fines are between 2 and 3 times the monthly minimum wage for individuals (depending on the number of violations) and 3 to 4 times the minimum wage for legal entities.

80. There is also a schedule of fines for inaccurate tax declarations and fines for non-payment of arrears. The Tax Law (chapter 8) specifies the measures to be taken to collect arrears, as well as the penalties that can be imposed in case of non-payment of arrears, which include the imposition of a fine equivalent to 30 percent of the tax debt, and seizures of assets.

81. In summary, the administrative sanctions are clearly specified in the primary legislation but given that they are calibrated in terms of the minimum wage they are considered by the GDT to be too severe for individuals and small and medium enterprises (SMEs) and insufficient to deter non-registration and non-filing by large enterprises.

iii) Planning and monitoring of tax audit and fraud investigation programs

82. In Mongolia personal income tax, corporate income tax, and value-added tax (VAT) are self-assessed by the taxpayers and therefore a well-functioning audit function is of very important for enforcing compliance in a transparent manner. The GDT's audit function is specified in an administrative procedure, with the methodology for conducting audits determined by the Tax Audit Methodology Department of the GDT. Audits apply to all the self-assessed taxes and are conducted by the various district tax offices and the Large Taxpayer Unit based on this methodology. In total there are roughly 300 tax inspectors who are charged with conducting audits.

83. The GDT conducts two types of audits: audits conducted based on an annual Audit Plan that uses a risk management system; and ad hoc audits based on complaints received from various parties (government organizations, citizens) as well as on GDT's own initiative. The total number of audits conducted in the last 4 years by each of these two types is given in Table 19.

84. The risk management system that forms the basis of the annual audit plan uses tax data, administrative and financial data on taxpayers from other sources and a software program based on 120 parameters to determine the risk ratings of taxpayers, ranging from a "High" to a "Low". High risk taxpayers are required to be audited once every two years, while low risk taxpayers are required to be audited once every five years, and the duration from the last audit forms one of the 120 criteria used in the risk management system. While the criteria for the risk-based audit are clear, problems in the quality of the taxpayer data identified above compromise the effectiveness of the audit, as does the limited number of tax inspectors to conduct the audit.

85. The number of ad hoc audits has increased rapidly over the past two years, and in 2013 constituted 40% of all audits (Table 19), and these apply to all the self-assessed taxes. Interviews with the chambers of commerce suggested that this increase resulted from the revenue shortfalls of the past two years and the pressure to collect additional taxes to meet the monthly revenue collection targets from the MoF and GDT. These ad hoc tax audits have generated numerous complaints of harassment from the business community.

86. Overall, therefore the coverage of the risk-based audits is only partial for the self-assessed taxes.

Table 19: Tax audits conducted, 2010-2013

	2010	2011	2012	2013
Audits based on annual audit plan (1)	9,029	10,725	7,484	8,094
Other audits (2)	2,015	2,263	2,509	5,426
Total audits conducted (3)= (1) + (2)	**11,044**	**12,988**	**11,291**	**13,520**
Percentage of audits based on annual audit plan (1)/(3)	**82%**	**83%**	**66%**	**60%**
% Total registered taxpayers	83,000	83,271	10,6225	10,7000

Indicator	Score	Explanation	Information sources
PI-14 Effectiveness of measures for taxpayer registration and tax assessment	**C+**	**M2 Scoring Method**	
(i) Controls in the taxpayer registration system	C	There are multiple taxpayer registration systems by tax type, and these are weakly linked to other registration and licensing systems.	Interviews with staff of the GDT
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	B	Penalties are clearly specified in the primary tax legislation, but are too small for large taxpayers to deter non-compliance	General Taxation Law (Articles 74 and 75); Interviews with GDT Tax Collections Department
(iii) Planning and monitoring of tax audit and fraud investigation programs	C	Audits apply to all self-assessed taxes. 60% of audits in 2013 were based on an annual audit plan using clear risk criteria, and the remaining were ad hoc audits. Ad hoc audits have been increasing in number since 2011. The high proportion of ad hoc audits imply that audits are not overall based on a clear risk assessment criteria.	Data from GDT Tax Audit Department; interviews with GDT and Chamber of Commerce

PI-15 Effectiveness in the collection of tax payments

i) Collection ratio for gross tax arrears

87. Tax arrears are high, amounting to 570 billion togrogs in 2013, or approximately 10 percent of gross tax revenues (Table 20). Arrears are classified as two types: those that are based according to the self-assessment by the taxpayers (i.e. difference between the assessed tax liabilities and those that were actually paid) and those resulting from tax audits. GDT has debt collection targets of 90 percent for the self-assessed arrears, and 85 percent from the arrears from audits. The actual collections have been 70 percent over the past two years.

Table 20: Tax arrears and debt collection (billions of togrogs)

	2012	2013
TOTAL ARREARS as of January 1st	**462.8**	**571.7**
Outstanding arrears by tax returns	418.2	516.5
Outstanding arrears by other audits	44.6	55.1
TOTAL ARREARS outstanding as of Dec 31	**137.3**	**160.6**
Outstanding arrears by tax returns	110.4	131.5
Outstanding arrears by other audits	26.9	29.1
Arrears paid within that year	**325.5 (70%)**	**411.0 (72%)**
Arrears paid by tax returns	307.8	385.0
Arrears paid as a result of other audits	17.7	26.0

Source: GDT

ii) Effectiveness of transfer of tax collections to the Treasury

88. The MoF and GDT have agreements with various commercial banks to receive payments from taxpayers. These tax collection accounts with commercial banks are swept daily to show zero balances, with the funds transferred to the Treasury Single Account held with the Bank of Mongolia.

iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury

89. The 32 local tax offices responsible for tax collections report on a daily basis to the GDT. Consolidated reports are produced on a monthly basis at the end of every month that contains data on assessments, collections, and transfers to the TSA. These reports are reconciled with the data maintained in the GFMIS on the amounts received in the TSA.

Indicator	Score	Explanation	Information sources
PI-15 Effectiveness in the collection of tax payments	**C+**	**M1 Scoring Method**	
(i) Collection ratio for gross tax arrears	C	The average debt collection ratio in the two years is 70% and the total amount of arrears is significant	Data from the GDT Collections Department
(ii) Effectiveness of transfer of tax collections to the Treasury	A	Funds are transferred at the end of each business day from the accounts of the commercial banks to the TSA held in the central bank	Interviews with staff of the GDT Collections Department and MoF Treasury Department
(iii) Frequency of complete accounts reconciliation	A	Complete reconciliation of tax assessments, collections, arrears, and transfers to Treasury takes place monthly at the end of every month.	As above

PI-16 Predictability in availability of funds for commitment of expenditures

i) Degree to which cash-flow forecasts and monitoring are carried out

90. The Treasury Department prepares a cash flow forecast at the beginning of the fiscal year. The forecast of revenue for the year is generally completed by February 1, and is based on historical revenue flows over the previous five years and data collected from revenue agencies. By early February, the annual forecast of expenditures is completed based on monthly budget allocations made by the Fiscal Policy and Planning Department and by fixed obligations such as debt service. Revenues are monitored on a daily basis through generation of a daily revenue statement, and forecasts for the remainder of the year are updated at least weekly and sometimes daily. Expenditures are reviewed monthly based on the execution reports, and forecasts are adjusted for succeeding months.

91. The quality of these cash forecasts is generally poor. The quality of the revenue forecasts is compromised by missing data from certain agencies (especially the General Department of Taxation, the Customs Administration, and the Oil and Petroleum Agency) because of difficulties in consolidating information from remote offices across the country. The quality of the expenditure forecasts is also poor because they

are based on historical approved monthly budget allocations, which are frequently revised based on cash availability and requests for the line ministries, as discussed below. Capital expenditures are particularly volatile because they bear the brunt of the expenditure cuts and therefore the historical data cannot do not accurately estimate the cash needs of spending agencies.

ii) Reliability and time horizon of the information on maximum limits and payment commitments provided to the MDA during the year

92. The IBL requires that Parliament adopt the next year's budget by November 15th. After the budget's adoption, the Ministry of Finance sends letters to budget governors (MDAs) notifying them of their total budgeted expenditures and requesting preferred monthly budget expenditure allocations by December 15th. The Ministry reviews requests, clarifies them with MDAs by December 20th and issues monthly budget expenditure allocations by February 1. Monthly allocations are broken down by use (salaries and wages, supplies, investment projects) and are cumulative; allocations that are not used in one month in theory carry over to the next.

93. MDAs can request changes to their monthly budget allocations over the course of the year (for example, to accelerate an expenditure or change uses within a monthly allocation), and receive two weeks' notice of any requested changes that have been granted. Five or six times each year, the Ministry of Finance makes changes in monthly allocations for the balance of the year based on updated revenue collection and forecasts. Decisions regarding the changes, including amounts and uses, are made within the Ministry and communicated to MDAs with two weeks' notice prior to the start of a month. Procedures for allocation and reallocation are laid out in the IBL and implementing regulations.

94. Even if budget allocations have not been changed, the Ministry often uses non-transparent cash control mechanisms at the end of the year (such as delaying printing of checks) in response to cash flow deficit problems. No limits are placed on commitments. Commitments are not recorded in GFMIS.

iii) Frequency and transparency of adjustments to budgetary allocations at a level higher than MDA administrations.

95. Parliament amends the annual budget once or twice a year, based on updated revenue collections and expenditures. Amendments are undertaken pursuant to the rules set out in the Integrated Budget Law (Articles 34 and 42) as detailed in PI-27, and these rules are respected, but no adjustment mechanism exists that relates adjustment to the budget priorities in a systematic and transparent manner. There is also no predictable timing for these supplementary budgets, and often they are delayed resulting in the need for in-year monthly expenditure limits by the MoF. The 2013 budget amendment, which cut revenues and expenditures by 13 percent and 11 percent respectively, was only approved in end October (Table 21).

Table 21: Yearly Adjustments to Budgetary Allocations

	2013 Original Budget	2013 Amended Budget
Date of approval	2012-11-08	2013-10-24
Total revenue & Grants	7,258,092.4	6,338,060.1
Total expenditure & Net Lending	7,444,625.0	6,629,850.9
Total Balance (-)	-356,291.3	-340,756.0

Indicator	Score	Explanation	Information sources
PI-16 Predictability of availability of funds for commitment of expenditure	**D+**	**M1 Scoring Method**	
(i) Degree to which cash flow forecasting and monitoring is carried out	D	While a cash flow forecast is prepared for the fiscal year, and is updated monthly, it is of poor quality and does not provide a reliable forecast of the availability of funds.	Interviews with staff of MoF; IBL Article 38.
(ii) Reliability and time horizon of the periodic information during the year providing the MDAs with information about maximum limits and payment commitments	D	MDAs are provided monthly expenditure allocations at the beginning of the year, but these ceilings are changed five or six times a year and only two weeks in advance. Commitments are not recorded.	As above
(iii) Frequency and transparency of the adjustments made to the budgetary allocations available at a level higher than MDA administrations	C	Parliament makes significant in-year adjustments to budget allocations once or twice a year and amendments are done with only some transparency.	As above. IBL Article 34 and 42

PI-17. Recording of management of cash balances, debt and guarantees

i) Quality of debt data recording and reporting

96. Most debt data are recorded in the Ministry of Finance's Debt Management Division (DMD), and debt data cover both external and domestic debt. MED enters into concessional loans, but control and record of disbursements and repayment are the responsibility of MoF. However, DMD does not record any guaranteed debt, including the 2012 and 2013 government-guaranteed debt issues of the Development Bank of Mongolia. DMD did not record debt notes that were issued to contractors at the end of 2013 to pay invoices for which there was not enough spending authority.

97. DMD's debt database uses UNCTAD's DMFAS 6.0 to record most external (i.e. excluding government guaranteed) and some domestic debt. Domestic debt auctioned weekly by MongolBank (the central bank) since December 2012 is maintained in an Excel spreadsheet rather than in DMFAS. Data on the recorded external and domestic debt were complete and accurate as of yearend 2013. Due to some technical bugs in the system, DMFA has not been used to record domestic debt in 2014.

98. Debt repayment and disbursement data are updated on a monthly basis and reconciled semi-annually against creditor statements. Before 2012, there were many differences between creditor and DMD outstanding balances, but DMD balances were adjusted by the beginning of 2013. DMD issues monthly internal reports on debt payments and disbursements, quarterly public debt bulletins and an annual debt report. Reports were formerly posted on MoF's website, but none have been posted since transition to a new website.

Table 22: Overview of Status of the Debt Management System

Debt Data	Status
Foreign	Most foreign debt data are recorded in DMFAS 6.0, but government-guaranteed DBM bonds were not recorded.
Domestic	Most domestic debt data are recorded in either DMFAS 6.0 or Excel spreadsheet in 2013; and not recorded in DMFAS in 2014; but debt notes to contractors at yearend 2013 were not recorded.
Updating/Reconciliation	**Status**
Foreign Domestic	Recorded foreign and domestic debt data are updated monthly and reconciled semi-annually.
Coverage of Statistical Reports	**Status**
Foreign/Domestic	Statistical reports are in Mongolian, but appear to cover most foreign and domestic debt.
Regularity of Reports	**Status**
Foreign/Domestic	DMD issues monthly, quarterly and annual debt reports.
Coverage of Reports	**Status**
Monthly	DMD issues monthly internal reports on debt payments and disbursements
Quarterly	DMD issues quarterly public debt bulletins
Yearly	DMD issues an annual debt report.

Source: Ministry of Finance, Debt Management Division

ii) Degree of consolidation of the government's cash balance

99. The Treasury Department has been using a Treasury Single Account (TSA) for eight years. The TSA's coverage is quite comprehensive and encompasses the cash holdings/balances of budgetary central government and local governments. Excluded, either fully or partially, are the extra-budgetary funds (DBM, HDF, and SIF), the Fiscal Stability Fund, credits at commercial banks, and donor funded project accounts.

100. The TSA is kept in the central bank. Various revenue-collecting agencies (customs, tax, registration) maintain collection accounts with commercial banks, but these accounts are swept daily to show zero balances and commercial banks submit reports on this activity to MongolBank. Cash balances in most accounts are calculated and consolidated daily.

iii) Systems for contracting loans and issuance of guarantees

101. Debt is incurred and guarantees issued according to the provisions of the Integrated Budget Law and specific authorization by Parliament. The Securities Market Law (effective 1/1/2014) contains provisions related to the issuance of government debt, but these provisions have not yet been enforced and may be superseded by a proposed Debt Management Law. MoF and MED incur debt (issue securities and contract loans) on behalf of the government, but only MoF guarantees the issuance of debt by other governmental agencies such as the Development Bank of Mongolia. Decisions concerning the incurrence of debt are taken on an ad hoc basis, particularly by MED, without clear guidelines and transparent criteria and without regard to fiscal targets or medium-term debt management strategies.

Indicator	Score	Explanation	Information sources
PI-17 Recording and Management of Cash balances, Debt and Guarantees	C	**M2 Scoring Method**	
i) Quality of the records and reports presented on debt data.	C	Domestic and foreign debt records are complete, updated monthly and reconciled semi-annually. Data quality is considered fair, but some gaps and reconciliation problems are recognized. Reports on debt are produced quarterly.	Interviews with staff of the Debt Management Division
ii) Degree of consolidation of government cash balances	B	Most cash balances are calculated and consolidated daily, but some extra-budgetary funds (SIF, DBM) remain outside the arrangement.	Interviews with staff of the Treasury Department
iii) Systems for contracting loans and issuance guarantees	D	Government's incurrence of debt (issuance of securities and contracting of loans) and issuance of guarantees are approved by MED and MoF without a unified overview mechanism.	

PI-18 Effectiveness of payroll controls

i) Degree of integration and reconciliation between personnel records and payroll data

102. Personnel records of government employees are separately maintained in each of the more than 5000 budgetary organizations (MDAs, schools, hospitals, primary health centres, etc.) in Mongolia. Payroll is similarly decentralized. Each of these budgetary organizations has an administration and accounting department (or two separate departments in the larger organizations) that maintains the organization's accounts and personnel records, and which prepares the monthly payroll. Each budgetary organization is in charge of collecting and managing this information.

103. The lack of central control or oversight compromises the degree of reconciliation between personnel records and payroll data. The MoF exercise control only at the aggregate level for each budgetary organization. The monthly payroll has to be within the monthly budget allocations for the budget organization; the treasury system will not make payments if the payroll exceeds these ceilings. However, these ceilings are prepared on the basis of budgeted positions at the beginning of the fiscal year and are only updated annually with the budget. The ceilings are not adjusted to take into account staff changes during the course of the year (e.g. vacancies, retirements, new recruitments) with the result that there can be, and often is, a mismatch in the aggregate wage bill being transferred from the TSA into the accounts of the budget organizations for onward payment (in the case of lower level budgetary organizations like schools and primary health centres; for MDAs the transfers take place directly from the TSA into the individual bank accounts of staff) and the actual number of staff working in the organization, and/or a mismatch between the authorized positions against which the budget is allocated and the actual staff filling those positions (i.e. in terms of staff qualifications and rank). Some preliminary research by the Ministry of Education, which is currently developing a human resource management information system, has revealed a problem of ghost teachers.

104. Each budgetary organization sends its personnel records once a year to the separate oversight agencies, namely the MoF, the Civil Service Council, and the Ministry of Social Welfare. There are significant differences in the personnel data in these three organizations, which is symptomatic of the weaknesses in the payroll controls described above. There is no follow up and the data is not checked.

(ii) Timeliness in the introduction of changes to the personnel records and payroll

105. The changes to personnel records and the payroll are at the discretion of each budgetary organization. In ministries and central agencies these changes take place frequently and the payroll is reconciled with the personnel records, particularly given that payments are made directly into the bank accounts of the employees. However, in the lower level budgetary organizations like schools and primary health centres — which employ the majority of Mongolia's civil servants — there are few checks and controls to ensure consistency (apart from aggregate spending limits). The personnel records are only updated annually at the central government level when the budgetary organizations report to MoF, CSC, and MoSWL, but the data is of poor quality as noted above.

(iii) Internal control over changes to personnel records and payrolls data

106. The authority and basis for changes to personnel records and the payroll are clear. Any amendment to the personnel record is carried out by the authorized person in the administration department of the budgetary organization and changes in the payroll database by the authorized person of the accounting department of the organization.

(iv) Existence of payroll audits to check for oversight errors and/or ghost workers

107. No comprehensive (covering all central government entities) payroll audit has been conducted in the last three years. Instead partial audits and staff surveys were undertaken. Every year when the Mongolia National Audit Office carries out the audit of the financial statements, payroll is implicitly and partially looked at. This is also the case for the various audits that are carried out yearly (35 in 2012) at the level of the entities of central government. Moreover the Social Insurance Authority, an agency under the Ministry of Social Welfare undertakes systematically partial random staff surveys at various institutions of central government (and schools and hospitals) to ensure the status of the individuals being paid and whether or not social insurance is being honored. The tax office carries out the same kind of random surveys but this is less systematic than the Social Insurance Authority.

Indicator	Score	Explanation	Information sources
PI-18 Effectiveness of payroll controls	**D+**	**M1 Scoring Method**	
(i) Degree of integration and reconciliation between personnel registers and payroll data	D	Personnel records and payroll are decentralized in each of the 5000+ budgetary organizations. Payroll is on the basis of budgeted positions and not actual positions, resulting in inconsistencies between the payroll and the personnel records	Interviews with staff of MoF, CSC, MoE, schools, and primary health centers.
(ii) Timeliness of changes to personnel records and the payroll	D	Aggregate personnel records are only updated annually and there are significant inconsistencies in the data reported to the different central agencies.	As above
(iii) Internal control of changes to the staff register and payroll	B	Authority and basis for changes to personnel records and the payroll are clear.	As above
(iv) Payroll auditing to identify loopholes in controls and/or fictitious workers	C	Partial payroll audits or staff surveys have been undertaken within the last 3 years	As above and interviews with staff of MNAO

PI-19 Competition, value for money and controls in procurements

(i) Transparency, comprehensiveness and competition in the legal and regulatory framework

108. The legal framework meets four of the six listed requirements (Table 23):

Table 23: Mongolia's legal and regulatory framework for procurement

Documentary Requirement	*Fulfilled*	*Explanation*	*Information Sources*
1. Procurement legal framework is organized hierarchically and precedence is clearly established.	***Yes***	The Public Procurement Law of Mongolia 2005 amended through June 2011 (PPLM) is largely based on the 1994 UNCITRAL Model Law on Procurement of Goods, Construction and Services. The hierarchy and precedence of policies and procedures, guidelines, instructions, manuals and standard procurement documents are clearly established.	Public Procurement Law of Mongolia (Revised up to June 2011). Mongolian version available on www.e-procurement.mn English translation available on http://www.ppi-ebrd-uncitral.com/images/stories/Files_repository/Mongolian_PPL_2006_revised-EN.pdf
2. Procurement laws and regulations are freely and easily accessible to the public through appropriate means.	***Yes***	Procurement laws and regulations are freely available from the public procurement website.	www.e-procurement.mn
3. The legal framework applies to all procurement undertaken using government funds.	***No***	Article 3.6 of the PPLM which was added by the amendment of June 16, 2011 excludes procurement related to the activities of the Development Bank of Mongolia (DBM) under which about 50% of public infrastructure were financed in 2013. DBM has not established any procurement procedures for project beneficiaries including the line ministries for public infrastructure to follow. There is no record that any of the contracts financed by DBM were awarded through open competitive bidding.	PPLM 2013 Report on the implementation of the PPLM. www.e-procurement.mn www.dbm.mn
4. The legal framework makes open competitive procurement the default method of procurement and defines clearly the situations in which other methods can be used and how this is to be justified	***Yes***	Article 7.2 of the PPLM makes open competitive procurement the default method. Other methods and conditions for their use are stipulated in Chapter 3 of the law.	PPLM
5. The legal framework provides for an independent, administrative procurement review process for handling procurement complaints by participants prior to contract signature.	***Yes***	Article 55 of the PPLM Complaints regarding unfair or restrictive technical specifications, minimum qualification requirements or bidding conditions or collusion may be referred to the Authority for Fair Competition and Consumer Protection (AFCCP). Other complaints may be sent to the Legal and Public Procurement Policy Department of the Ministry of Finance (LPPPD/MOF)	PPLM
6. The legal framework provides for public access to all of the following procurement information: *government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints.*	***NO***	Procurement plans, bidding opportunities, and contract awards are publically available. Data on resolution of procurement complaints however, is not publicly accessible. LPPPD/MOF handled 254 complaints in 2013 and AFCCP handled 23 cases of restriction of competition in bidding documents in 2013, but the details are not publicly available.	LPPPD/MOF and AFCCP

(ii) Use of competitive procurement methods

109. Conditions and thresholds for the use of methods other than open competition are clearly stipulated in the PPLM and in the regulations. Even under limited bidding the procuring entity is required to advertise the opportunity in the event other qualified bidders not known to the procuring entity are interested. In the case of direct contracting, the procuring entity is required to deposit a copy of the contract and the justification with the LPPPD/MOF whose inspectors are required to audit such contracts ex-post. However reliable data on the value of such contracts which are legally justified is not available. Furthermore there are no established procedures for procurement of social projects that are financed by loans from DBM (i.e. those executed by ministries, as elaborated under PI-7). The majority of these projects were done through direct contracting, with no justification or public disclosure of the procurement method used. The magnitude of the procurement financed by loans from the DBM is roughly equivalent to that financed from the budget.

(iii) Public access to complete, reliable and timely procurement information

1. Procurement plans: ***YES*** for budget funded procurement, and ***NO*** for DBM funded.
2. Bidding opportunities: ***YES*** for budget funded procurement, and ***NO*** for DBM funded.
3. Award of contract: ***YES*** for both budget and DBM funded procurement
4. Resolution of procurement complaints: ***NO***. Data on resolution of complaints is not made available to the public.

110. Procurement plans, bidding opportunities and award of contracts are published for contracts under funded under the Government budget, which account for 50% of central government procurement by value, the rest being financed by the DBM. According to the LPPPD/MOF contracts awarded under the state budget in 2013 using the PPLM amounted to MNT 1,089,677 million. According to the 2013 Audit Report of DBM, loans amounting to MNT 1,018,242 million approx. were granted in 2013 for projects to be repaid from the state budget.

(iv) Existence of an adequate administrative procurement complaints system

111. Complaints sent to the LPPPD/MOF are handled by government officials. Similarly complaints on anti-competition provisions in bidding documents referred to the Chairman of the AFCCP are handled by inspectors who are government officials.

COMPLAINTS SYSTEMS

Complaints are reviewed by a body comprised of experienced professionals, familiar with the legal framework for procurement. This body, which includes members drawn from outside government
(i) Is comprised of experienced professionals, familiar with the legal framework for procurement, and includes members drawn from the private sector and civil society as well as government; ***No*** (ii) Is not involved in any capacity in procurement transactions or in the process leading to contract award decisions; ***Yes*** (iii) Does not charge fees that prohibit access by concerned parties; ***Yes*** (iv) Has the authority to suspend the procurement process; ***Yes*** (v) Exercise the authority to suspend the procurement process. ***Yes*** (vi) Issues decisions within the timeframe specified in the rules/regulations; ***Yes*** (vii) Issues decisions that are binding on both parties. ***Yes***

Indicator	Score	Explanation	Information sources
PI-19 Competition, value for money and controls in procurements	**D+**	**M2 Scoring Method**	
i) Transparency, comprehensiveness and competition in the legal and regulatory framework	B	The legal framework meets 4 of the six (6) listed requirements.	
ii) Use of competitive procurement methods	D	No documented regulations on procurement under DBM-financed projects. Under PPLM open competition is the preferred method and the conditions for use of less competitive methods are clearly stipulated.	
(iii) Public access to complete, reliable and timely procurement information	C	There is limited access to information on contracts financed by DBM. However, procurement plans, bidding opportunities and award of contracts are published for contracts under the PPLM which account for 50% of public procurement by value.	
(iv) Existence of an adequate administrative procurement complaints system	D	There is no documented complaints mechanism for contracts financed by DBM. The complaints mechanism under PPLM is robust but there is no representation from the private sector and civil society on the 2 complaints bodies.	

PI-20 Effectiveness of internal controls on non-salary expenditure

(i) Effectiveness of expenditure commitment controls

112. There is no formal system of commitment controls and commitments are not recorded in the GFMIS. Instead, the budget is executed based on a monthly budget allotment schedule that establishes expenditure limits, which is revised and adjusted every month. Budget entities cannot make payments above the expenditure limits programmed for the month. For the capital budget, contracts cannot be signed for works, equipment, and services above the amount that is authorized in the budget.

(ii) Scope, relevance and understanding of other internal control regulations and procedures

113. The Budget Law (2011) includes various provisions on internal control regulations and procedures (Articles 35 to 47). These internal control regulations and procedures are comprehensive and they are enforced. They cover the organization of the budget and the oversight of budget implementation, the coverage of the TSA, the issuance of authorization to finance and spend to budget entities' accounts (based on the monthly budget allotment schedule), the process of daily transactions of budget revenues and expenditures, the order for budget expenditure payment, the processing and control of budget

transactions, and recording activities. These internal control rules and procedures are well understood and implemented.

114. For capital projects rules and procedures are often excessive leading to unnecessary delays (for example, payments to suppliers require up to 11 signatures depending on the case). In particular, every payment for each project needs to be first authorized by the Fiscal Policy Department (MoF) before the payment can be made by the Treasury Department. Given that there are annually well over a thousand projects, each with between one and twelve payments annually (depending on the size of the project), and limited numbers of staff in MoF, this duplication of procedures results in unnecessary delays in payments.

(iii) Degree of compliance with regulations on the processing and registration of transactions

115. The degree of compliance with rules for processing and recording transactions is high. Treasury has indicated that at the level of their institution the processing of payment documentation has a relatively low rejection rate (5%). Comparable rejection rates are to be found for other transactions. Simplified procedures are not contemplated in the law. In addition no misuse of emergency procedures has been identified.

Indicator	Score	Explanation	Information sources
PI-20 Effectiveness of internal controls on non-salary expenditure	**D+**	**M1 Scoring Method**	
(i) Effectiveness of controls on expenditure commitments	D	There is no formal system of commitment controls and control is largely reliant on containing cash payments within approved budget allocations.	Treasury (MOF), Budget Law (2011)
(ii) Scope, relevance and understanding of other internal control regulations and procedures	B	Other internal control rules and procedures incorporate a comprehensive set of controls, which are widely understood, but may be excessive causing delays	As above
(iii) Degree of compliance with the regulations for processing and registering transactions.	B	Compliance with rules is high. Simplified procedures are not contemplated by the current legislation and no emergency procedure has been identified.	As above

PI-21 Effectiveness of internal audit

116. The IBL created the legal framework for establishing an internal audit function in public sector entities in Mongolia. This new internal audit function, created in 2012, supplements the Monitoring and Evaluation (M&E) function that was created in 2004 and has been functional since 2006. Many of the new internal auditors have moved over from the M&E function and some continue to perform both functions.

117. By March 2014, an internal audit function had been established in all line ministries and 46 ministries and agencies in total. Additionally, an internal audit committee had been established at each line ministry.

118. The Ministry of Finance is legally responsible for providing methodologies and guidelines for the public

internal auditor. This function, as well as the execution of internal audits of MOF, is executed by the Internal Auditing, Monitoring and Evaluation Division (IAMED) which reports to Budget Control and Risk Management Department (BCRMD) of the Ministry of Finance. The Internal Audit Charter establishes that internal audit units in ministries and agencies will report to the Budget Governor of the institution or the Internal Audit Committee, if there is one. Thus, the internal audit function was established conscious of the principle of independence.

119. The Ministry of Finance represents Mongolia as a corporate member of the International Internal Audit Associations (IIA). An Internal Audit Charter and Medium-term Strategy have been approved by the Government.

(i) Coverage and quality of the internal audit function

120. Throughout 2013, a total of 144 internal audits were conducted by the internal audit units; 61 for the line ministries and 83 for their agencies. More than 50% of these audits were reported as systemic audits with preliminary agreed plans, thus more than 72 audits were systemic audits which were conducted based on the guidelines with systemic approaches to review and improve the effectiveness of public sector entity risk management and control processes. The remaining percentage of internal audit work involved specific purpose reviews. It is the clear intention of internal audit management to avoid pre-control activities.

121. MOF internal auditors have provided on-site training during internal audits carried out at the line ministries and jointly conducted internal audits at the Custom Authority and Tax Authority. Thus, MOF internal auditors were involved in 32 internal audit engagements for the line ministries and 33 for the government agencies, namely in the areas of tax and customs administration.

122. While Mongolia's auditing standards comply with international standards a consistent understanding and application of these standards and audit guidelines across the many new public sector internal audit units and individual internal auditors is still lacking. The International Standards for the Professional Practice of Internal Auditing (IIA standards) were fully translated into the Mongolian language. Public sector internal audit guidelines that comply with the IIA standards were published and distributed to public sector internal auditors. A number of internal audit training workshops were subsequently delivered based on these documents. However, a number of the mandatory IIA standards have not been fully met at this early stage in the establishment of public sector internal audit. These include:

1110 Organization Independence, in respect to the relationship between IAMED and BCRMD,
1130 Impairment to Independence or Objectivity, in respect to resource limitations, such as funding,
1210 Proficiency, in respect to the demonstration of competencies through professional certifications such as the Certified Internal Auditor (CIA)
1310/1311 Quality Assurance and Internal Assessments, in respect to the ongoing monitoring of IA performance and periodic self-assessments
2030 Resource Management, in respect to appropriate and sufficient resources
2050 Coordination, in respect to not distributing audit reports to the SAI
2120.C3 Risk Management, in respect to the relationship with BCRMD
2430 Conformance with International Standards, in respect to the lack of quality assurance assessments to confirm conformance
2500 Monitoring Progress, in respect to the lack of a monitoring system established by the Chief Audit Executive to monitor and ensure that actions have been effectively implemented.

123. Public sector internal auditing however is still relatively in its infancy in Mongolia. Much remains to be done to ensure that the function continues to grow and obtains a reputation for delivering consistently

high auditing and advisory services, government-wide, to officials responsible for government programs and are reflected in more effective, efficient and economic services delivered to the public. More auditors need to be trained to achieve better audit coverage and high quality audits. A significant percentage of internal auditors and audit reports are in just three ministries. Many other internal audit units are recently established and therefore have only one or two auditors. Steps need to be taken to be able to confirm that internal audit is in compliance with international standards.

(ii) Frequency and distribution of reports

124. Internal audit reports were issued for the 72 systemic internal audit engagements mentioned above, and limited reports were issued for specific purpose audits. All reports are distributed to the respective Internal Audit Committee and audited entities/departments but only some of them are submitted to MOF. During 2013, the MOF collected 14 internal audit reports prepared by line ministries' internal audit units and 32 from government agencies. Upon the receipts of the reports, the MOF has often taken the reports as experience sharing examples; however, there have not been consistent review procedures implemented. Internal audit reports are also not distributed to the Mongolia National Audit Office (MNAO, Mongolia's supreme audit institution) upon their completion. MNAO auditors however obtain and review the internal audit reports at the planning stage of their annual audits.

(iii) Extent of management response to internal audit findings

125. Public entities maintain their own "non-obligatory" databases for their internal audit engagements that allow the entity to facilitate tracking IA findings, do follow-up, calculate implementation percentages, and prepare action plans. The quality of actions, however are not well analyzed. On average it takes four months for the ministries to take action on the audit findings after the delivery of the reports. Therefore, follow-up mechanisms for audit findings and recommendations are still not well systematized with appropriate templates that enable monitoring the quality and responsiveness of implementation actions.

126. The latest available financial and operational information were the reference for all three PI-21 dimensions.

Indicator	Score	Explanation	Information sources
PI-21 Effectiveness of Internal Audit	**C+**	**M1 scoring method**	
(i) Scope and quality of internal audit function	B	As of year-end 2013, around 80% of line ministries and government agencies have full time internal auditors. Audits are at least 50% systemic in nature. Steps need to be taken to be able to confirm that internal audit conforms to international standards.	
(ii) Frequency and distribution of reports	C	Distribution of audit reports to both MOF and MNAO has not been established as a regular practice. MOF receives only some audit reports and audit reports are not distributed to the MNAO. Audit reports are shared with the MNAO auditors at the time of the annual audit.	
(iii) Management response to internal audit findings	C	Average action period is four months after delivering the internal audit report to the audited department. There are no indications on the quality of actions in the IA databases.	

Subsection 3.5: Accounting, recording and reporting

PI-22 Timeliness and regularity of accounts reconciliation

127. As noted under PI 17, the TSA, maintained in the central bank, is used for almost all budgetary transactions, with the separate accounts of the various revenue-collecting agencies (customs, tax, registration) maintain collection accounts swept daily to show zero balances with commercial banks submit reporting on this activity to central bank. The GFMIS is used to process, record and report transactions. All transactions paid through the TSA are recorded separately for each entity against the approved economic classifications for the purpose of monitoring budget execution.

128. Mongolia has been working towards implementing accrual based IPSAS. In addition to recording cash payments in GFMIS, all entities record their cash and non-cash transactions on an accrual basis in locally procured accounting software packages such as ACULOUS and others for financial reporting purposes that are not integrated with GFMIS. Advance accounts for travel, to contractors and other similar advances are therefore recorded and controlled in the entity accounting and financial reporting systems. MOF consolidates the Government financial statements twice yearly through a consolidation software package called PLASTIC. MOF therefore has no drill-down capability into entities' balance sheet accounts.

i) Regularity of bank account reconciliations

129. Confirmation of the consolidated balance of the TSA is done daily between the Bank of Mongolia and the Treasury Department on the next working day. For the accounts maintained outside of the TSA in commercial banks by the revenue generating agencies on their activities the account balances are zeroed and cleared on a daily basis to the state revenue account in the TSA held in the central bank. Cash transactions that do not clear are returned to the sender's bank but are tightly controlled by Treasury.

(ii) Regularity of reconciliation and clearance of suspense accounts and advances

130. MOF has a policy of not allowing suspense accounts and reviews budget entities' chart of accounts to enforce this policy. Unexplained or unusual transactions are therefore persistently cleared and not accumulated in suspense accounts. For cash receipts, unidentified cash is returned to the remittent bank and closely controlled. MNAO confirmed the effective application of this policy.

131. Advance accounts are used to record advances for travel, mobilization advances to contractors as required by contract, and for other similar purposes. These advances are to be documented and eliminated a reasonable time after travel or as stipulated by contract. During the semi-annual consolidation process, account analysis is done of advance accounts to ensure compliance with policy and contract requirements. A low level of advances, typically around 2% of total asset, is carried on the Balance Sheet at year-end. The audit review of advance accounts transactions and balances helps to ensure the proper enforcement of Government advance policy and contract advance clauses.

132. Additionally, budget entities are able to track transactions and balances accurateness through an online portal and confirm GFMIS budget execution report accuracy versus the entity's own records. These reconciliations are required to be done monthly within 4 working days of the GFMIS monthly closing. While GFMIS is not integrated with financial reporting packages that control advance accounts, this monthly reconciliation process helps to maintain the integrity and reliability of budget entity financial information and detect errors on a timely basis.

Indicator	Score	Explanation	Information sources
PI-22 Timeliness and Regularity of Accounts Reconciliation	**B+**	**M2 scoring method**	
(i) Frequency of reconciliation of bank accounts	A	Bank account reconciliations for the TSA and for the accounts held in commercial banks are done on a daily basis between the Treasury department and the Central Bank.	
(ii) Frequency and reconciliation and clearance of accounts and advances	B	Suspense accounts are not permitted for budget entities and suspense transactions through the GFMIS are rejected, returned to the remitting bank and closely controlled. Account analysis review of suspense accounts is done twice yearly within two months of end of period. As Mongolia is working towards IPSAS accrual basis the carrying of advance balances at year-end is normal. The number of advances and values are reasonable.	

PI-23 Availability of information on resources received by service delivery units

i) Compilation and processing of information to show the resources effectively received (in money or in kind) by the majority of front-line service delivery units (with particular focus on primary schools and primary health care clinics) in relation to the resources made available by the relevant sector or sectors, regardless of the level of government responsible for the functioning and funding of these units.

133. In Mongolia, primary service delivery units like elementary schools and primary health care clinics are independent budget entities (Direct Budget Governors, as per the terminology in the Budget Law) with an annual budget allocation and a monthly budget allotment that determines how much they can spend per month. As per the Budget Law (Articles 58 and 61), basic education and health are functions that are delegated from the central government to sub-national governments, which implies that the budgeting for service delivery units is a dual responsibility of the central and sub-national governments. The budgeting process works as follows: The Ministries of Education and Health prepare the annual budgets based on, for the most part, capitation financing formulae that determines the allocation for each service-delivery unit based on school enrollment and population coverage. These budgets are then aggregated up to the aimag level, and the aimag governor is then given authority to distribute this aggregate budget between the soums and front-line service delivery units to take into account particular local needs. The annual budget, approved by the parliament on November 15th of each year then authorizes this allocation.

134. Once the budget is approved and the monthly allotment determined by the MoF, the budget is entered into the GFMIS (the Treasury system). Each school and primary health centre has an administrative code in the GFMIS and, as Direct Budget Governors, school principals and primary clinic directors are authorized to spend the budget allocated as per the Government rules and regulations (in other words, just like any other spending entity). Every month the accounting departments of these schools and clinics prepare bills that are submitted to the local Treasury offices which are checked for compliance following which the requisite payments are made from the Treasury Single Account. There is no involvement of the sub-national governments in these payments, and no separate sub-national accounts into which funds may be transferred.

135. There are some small delays in the budget allotment and in the payments from the TSA to the service delivery units. While the annual budget is approved by November 15th of each year, the monthly allotment (laying out the monthly schedule of the budget) is usually not approved until the end of January. It usually takes on average between 10 days and two weeks after the submission of the monthly invoice for the Treasury to make payments to the school and health center accounts (schools and health facilities are akin to vendors) for onward payment of salaries and other expenses.

136. Data on budget allotments and execution are prepared on a monthly basis (as per the Government's regular reporting requirements) by the front-line delivery units and are sent to the aimag and to the respective ministries. These are then consolidated into monthly budget execution reports by the MoF. These reports reveal that front-line service delivery units spend most of their budgets. The Treasury department can also query the GFMIS to generate real-time reports on budget execution for the service delivery units.

137. There are no significant in-kind transfers from the central government and the service delivery unit budgets, described above, provide a comprehensive picture of the resources available to these units.

Indicator	*Score*	*Explanation*	*Information sources*
PI-23 Availability of information on resources received by service delivery units	***A***	***M1 Scoring Method***	
Compilation and processing of information to show the resources effectively received (in payment or in kind) by the majority of front-line service delivery units.	A	The GFMIS provides monthly information on budget allocations and expenditures, which are used to produce monthly budget execution reports. These reports reveal that front-line service delivery units spend most of their budgets.	2013 Budget and budget execution reports; Interviews with select primary school and primary health centre staff

PI-24 Quality and timeliness of in-year budget reports

(i) Scope of the reports in terms of coverage and compatibility with budget estimates

138. In-year budget execution reports are legal requirements (Budget Law, 2011, Art. 54.5). Budget execution reports are prepared on a monthly and quarterly basis and show actual expenditures and revenues compared with the approved budget. These reports follow the budget classification and consist of administrative and economic classification and are based on payments but not on commitments. The reports are produced by the budget entities using a locally developed accounting software (Accolous) that is maintained in desktop systems in each of the budget entities. The data is reconciled monthly with the Government's Treasury system (GFMIS).

139. This manual reporting leads to task duplication and inefficiencies. Ideally the GFMIS should be used to automatically generate execution reports but this is not being done because of the inconsistencies between the CoA used for the budget and for treasury discussed earlier. The flash reports that are generated with the GFMIS (Crystal reports) are at a very detailed level of classification and cannot be used for reporting on budget execution.

(ii) Timeliness of report presentation

140. In-year budget reports are prepared on a monthly and quarterly basis and are issued within ten days after the end of the month and within two weeks after the end of the quarter respectively. The reports for FY2013 are available on the MoF website with their issuance dates.

(iii) Quality of information

141. The manual data entry and use of desktop based accounting software, and the different reporting structures of the GFMIS and the budget can result in errors in the budget execution reports. Due to the monthly reconciliation with the GFMIS the magnitude of these errors are considered to be small by the Treasury Department but are not fully known nor stated in the reports. These problems however, do not compromise the overall usefulness of the reports which are used by the MoF to track revenues and expenditures, revise the monthly budget allotments and to prepare supplementary budget proposals for parliamentary approval.

Indicator	*Score*	*Explanation*	*Information sources*
PI-24 Quality and timeliness of in-year budget reports	*C+*	***M1 Scoring Method***	
(i) Scope of reports in terms of coverage and compatibility with budgetary forecasts	C	Comparison of the budget is possible by administrative and economic classification. Expenditure is captured at the payment stage only.	Budget execution reports on MoF website (www.mof.gov.mn).
(ii) Timeliness in the presentation of reports	A	Monthly reports are issued within ten days after the end of the month; quarterly reports are issued within two weeks after the end of the quarter.	Budget execution reports on MoF website.
(iii) Quality of the information	C	Manual data entry and the lack of integration between the accounting and payment systems create some concerns about the quality of the data in the reports. These data issues are not highlighted in the reports. However, this does not compromise their basic usefulness.	PI-5 and IMF, Report by Arun Kumar Srivastava (November 2013).

PI-25 Quality and timeliness of annual financial statements

142. The IBL (Article 26) requires budget entities in Mongolia to prepare financial statements on the full accrual basis of accounting. The Accounting Law of Mongolia (Article 10) also mandates that all budget entities shall prepare their financial statements in line with International Public Sector Accounting Standards (IPSAS). The Government has adopted the 2003 version of IPSAS and has initiated a process of adopting IPSAS (accruals).

143. Both MOF and MonICPA, the Mongolia Institute of Certified Public Accountants, support the wide adoption of IPSAS within the Mongolian public sector through participating in translation, development of a manual based on IPSAS and conducting training for public sector accountants. MOF, with the support of MonICPA, completed translation of the most recent suite of IPSAS in 2012. The Ministry of Finance and

the Mongolian Institute cooperate to provide public sector entities with the current IPSASB handbook of pronouncements.

144. Despite a supportive legal framework and the activities noted above, implementation of accrual accounting in the public sector is not yet complete. Not all IPSAS standards have been issued and some of those that have been issued only partially comply with the IPSAS accrual standards. There is no progress report showing the level of IPSAS implementation.

145. PI-25 dimensions (i) and (ii) were assessed based on the last financial statement submitted for audit, which was 2012. Dimension (iii) was assessed on the last three years' financial statements for the periods ending December 31, 2010, 2011 and 2012.

(i) Comprehensiveness of financial statements

146. Consolidated financial statements for the Government of Mongolia are prepared two times each year. The consolidated financial statements include both central and subnational entities. The consolidation includes wholly-owned entities and those in which the government's participation in ownership is 90% or greater, as well as project/programs and funds implemented/managed by Government ministries and agencies. As such, the 2012 Consolidated Financial Statements of the Government covered the financial statements of 127 state-owned entities, 164 entities owned by local governments, and 93 projects and funds. Both DBM and the State Bank are included in the consolidation. However, some of the largest SOE's in which the government's ownership is less than 90% are not included in the financial statements as required by IPSAS.

147. The accounting framework for presentation of the financial statements is accrual based IPSAS, as required by law. The financial statements therefore present information on revenues, expenditures, assets, liabilities and equity accounts. The information on assets includes cash, short-term investments, receivables, advances, inventory, reserves, long-term assets and other fixed assets. Liabilities include short-term liabilities, securities, loans, payables, unearned revenues, long-term securities and long-term loans. The net assets consist of government contributions.

148. Pension liabilities are not accrued on an actuarial basis as required by IPSAS. These liabilities can be material to the financial statements taken as a whole. In many countries this is the largest liability on the financial statements. The actuarial liability has not been calculated in Mongolia.

(ii) Timeliness in the presentation of financial statements

149. Consolidated financial statements are prepared two times per year. The annual consolidated financial statements are required to be submitted to the MNAO for audit by May 10th of the year following the end of the financial statement reporting period (December 31). The consolidated financial statements for the year-ended December 31, 2012 were submitted to MNAO on May 10, 2013.

(iii) Accounting standards used

150. The Government has been engaged in a gradual process since 2003 of implementing accrual based IPSAS, as required by law, but the standards are not yet fully implemented. The financial statements for 2010, 2011 and 2012 have been prepared in a consistent format.

Indicator	Score	Explanation	Information sources
PI-25 Quality & timeliness of financial statements	***C+***	***Scoring method M1***	
(i) Completeness of financial statements	B	A consolidated government financial statement is prepared annually. They include, with few exceptions, full information on the revenues, expenditures, assets, liabilities and net assets.	IBL (Article 26), Accounting Law (Article 10)
(ii) Timeliness in the presentation of financial statements	A	The annual consolidated government financial statement is submitted for external audit within six months of the end of the fiscal year.	
(iii) Accounting standards used	C	Financial statements have been prepared in a consistent format but accrual based IPSAS is only partially applied.	

Subsection 3.6: External Scrutiny and Audit

PI-26 Scope, nature and follow-up of external audit

151. The Mongolian Law on State Audit of 2003, with the latest amendments made in 2013, establishes the Mongolian National Audit Office (MNAO) as the country's Supreme Audit Institution (SAI). As such, MNAO is mandated to perform audits of activities of state entities, except for the Parliament, irrespective of the source of their funding. Only the financial statement audit of the Parliament is conducted and an audit of its other activities may be carried out by MNAO, if the Parliament requests so. In parallel, the IBL requires state entities at the various levels of budget holders to have their financial statements audited annually within the timeframe specified in the law.

152. MNAO has auditors in its Financial Audit Department who conduct audits of portfolio ministers' financial statements and the consolidated year-end financial statements of the Government. When deemed appropriate, MNAO outsources state entities' audits to private audit firms while maintaining the quality assurance function for those outsourced audits.

153. MNAO is a member of INTOSAI (International Organization of Supreme Audit Institutions) and ASOSAI (Asian Organization of Supreme Audit Institutions). MNAO auditors follow the International Standards on Auditing (ISAs) as promulgated by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) when conducting audits of state entities. The International Standards of Supreme Audit Institutions (ISSAIs) have not yet been translated into Mongolian.

154. All three dimensions of the external audit function were assessed based on the last fiscal year audited, which was 2012.

(i) Scope/nature of the audit carried out (including compliance with auditing standards)

155. As the external auditor of the government, MNAO conducts both systems audits and transaction reviews and is organized into three core audit departments in addition to administrative and strategic management departments: financial audit, performance audit and compliance audits. As indicated in the MNAO's annual report to the Budget Standing Committee in year 2013, it conducted 311 performance audits, 4099 financial statement audits and 196 compliance audits; thus performing a total of 4606 audit

engagements. The number of staff, inclusive of those at the subnational level, as approved by the decree of the Budget Standing Committee of the Parliament for MNAO is 389.

156. Funds, projects and programs implemented and/or managed by Government ministries and agencies, fully (100 percent) state-owned enterprises, and enterprises fully owned by the local governments are all required by the IBL (Article 54) to get their financial statements consolidated into the Government financial statements. As such, the 2012 Consolidated Financial Statements of the Government covered financial statements of 127 state-owned entities, 164 entities owned by local governments, and 93 projects and funds. As a 100 percent state-owned entity, and as required by its own law (Article 2 of the Law on the Development Bank of Mongolia), the Development Bank of Mongolia also gets its annual financial statements audited and consolidated to the Government's consolidated financial statements.

157. As required by law, all central government entities' financial audits are carried out annually within the timeframe set forth by the law. In addition to auditing budget execution reports covering revenues and expenditures, financial statements covering assets and liabilities are audited. In year 2013, out of the 459 financial statements consolidated in the 2012 Consolidated Financial Statements of the Government, 199 (43.3%) were audited by MNAO and the remaining 260 (56.7%) were audited by private audit firms. 2012 financial audit reports of all 35 general budget governors (inclusive of the agencies belonging to the various portfolio ministries) representing the central government were produced and made available to the public on the MNAO website.

158. The MNAO audit opinion on the 2012 Consolidated Financial Statement of the Government made a reference to the IFAC-issued International Standards on Auditing (ISA) and the MNAO Financial Audit Manual that is in compliance with the ISAs as the standards it followed when conducting the audit. The audit opinion of the external auditors on the 2012 Consolidated Financial Statement of the Government was qualified due to issues such as inaccurate reporting of the cash balance, insufficient documentation of expenditures incurred for issuing sovereign bonds, inability to verify the balance of on-lending receivables, duplicate reporting of interest expenses, etc.

Table 24: Scope and nature of audits carried out on ministries & audit standards (2012)

Elements covered	% of expenditure audited	Audits carried out	Audit standards applied
Revenues and expenditures as well as assets and liabilities	All central government entities, except for the parliament	In addition to performing financial audits, as included and approved in its annual work plan, MNAO conducts performance audits and compliance audits covering a variety of matters.	International Standards on Auditing

Sources: 2013 Annual Report of MNAO operations and MNAO website

(ii) Timeliness in submission of audit reports to the Legislature

159. The IBL (Article 8) sets forth the following schedule, as it pertains to the central government entities, for the annual audited financial reports submission at the various levels of budget governors:

- Direct budget governors shall submit annual budget execution reports and financial statements by the 25th of January of the following year to state audit bodies and audited financial statements to the respective upper level budget governors by the 25th of February.
- Central budget governors shall prepare and submit annual budget execution reports and financial

statements to the state audit body no later than the 5th of March and submit audited reports to the general budget governor no later than the 25th of March of every year.

- General budget governors shall submit annual budget execution reports and consolidated financial statements by the 5th of April of the following year, and submit audited annual statements by the 25th of April of the following year to the Ministry of Finance for consolidation.
- The Ministry of Finance shall submit the unified budget execution report and Government's consolidated financial statement to MNAO by the 10th of May of every year.
- MNAO shall conduct audits of the unified budget execution report and Government's consolidated financial statement within one month (by the 10^{th} of June) and submit its audit opinion to the Government and the Parliament.

160. As indicated in the schedule, although the annual budget execution reports and financial statements of central government entities at the portfolio minister's (general budget governor's) level are audited within the first 4 months of the following year, until consolidated into the unified budget execution report and the consolidated financial statement of the Government they are not required for submission to the legislature by law. A sample review of the individual ministries' 2012 audit reports yielded the following results:

- Cabinet Secretariat: 2012 audit report was issued by MNAO on April 24, 2013
- Ministry of Foreign Affairs: 2012 audit report was issued by MNAO on April 24, 2013
- National Statistics Office: 2012 audit report was issued by MNAO on April 24, 2013
- Social Insurance Fund: 2012 audit report was issued by MNAO on April 25, 2013

161. Based on the sample review, it was concluded that the annual audit reports of individual central government entities were prepared timely within the legal deadline of April 25.

162. The 2012 year-end consolidated financial statement of the Government was audited by MNAO and the audit report was issued and submitted to the Parliament on June 7, 2013, slightly over five months after the end of the period covered.

(iii) Evidence of follow up on audit recommendations

163. As part of an individual ministry's or agency's annual audit report a Management Letter detailing the auditor's main findings is provided. In the Management Letter, auditors rank the findings by priority and provide space for the management of the audited government entity to formally make a response to the specific findings in writing and provide signature.

164. Based on a sample review of Management Letters provided to Government entities as part of their 2012 audit reports, it was found that where applicable the external auditors had provided time-bound recommendations, documented the management responses in writing, analyzed the recommendations provided (e.g. out of the 106 recommendations provided to general budget governors during their 2012 audit, 28.3% were for enhancing responsibilities, 23.6% were for improving management, 15% for increasing effectiveness, 12.3% were for increasing service quality and provision, 11.3% were for increasing efficiency and 9.5% were for improving accounting practices and increasing budget revenues) and provided a summary on the status of implementation of the previous year's audit recommendations in an Annex to the Audit Report on the Consolidated Financial Statement of the Government that is submitted to the legislature.

165. There was also clear evidence in the audit reports that the external auditors had followed up on the previous year audit recommendations. For instance, the 2012 audit report on the Consolidated Financial Statements of the Government describes that out of the 75 recommendations provided to general budget governors in the previous year (2011), 80% were fully implemented, 5.3% were overdue and 14.7% were in progress for implementation.

Indicator	Score	Explanation	Information sources
PI-26 Scope, nature and follow-up of external audit	B+	**Scoring method M1**	
(i) Scope/nature of the audit carried out (including adherence to audit standards).	B	All entities of central government are audited annually covering revenue, expenditure and assets/liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues. The only exception is the parliament which is not regularly audited.	IBL.
(ii) Timeliness in the presentation of auditing reports to the Legislature	B	Audit reports are submitted to legislature within 8 months of end of period covered and in the case of financial statements from their receipt by the auditor.	
(iii) Evidence of follow up of audit recommendations	A	There is clear evidence of effective and timely follow up.	

PI-27 Legislative scrutiny of the annual budget law

i) Scope of examination by the Legislature

166. The State Great Khural (the national parliament of Mongolia) exercises considerable authority over the budget, as specified in the Budget Law (Article 9). It approves the Government's Medium Term Fiscal Framework (MTFF), the annual development vision (called Guidelines for Socio-economic Development), the annual budget, and supplementary budgets.

167. As per the calendar specified in Article 8 (and which is strictly adhered to), the MTFF is presented by the Government to parliament on May 1st of each year, with parliamentary approval by June 1st. The MTFF has to abide by the fiscal rules specified under the Fiscal Stability Law, but there is considerable debate during the parliamentary discussions on the macroeconomic assumptions and revenue forecasts that underpin the rules and therefore the MTFF. It is common for the parliament to change these assumptions, almost always with the goal of increasing spending. De jure and De facto therefore, parliament exercises considerable power in setting the revenue and expenditure aggregates used to prepare the budget.

168. The annual budget has to be presented to the parliament by October 1st with approval by November 15th. These dates have always been abided by. The only limitation is that the budget has to abide by the fiscal rules specified in the FSL; other than this restriction the parliament can, and does, review all details of revenues and expenditures. During the parliamentary debate there are many changes made to the budget, particularly the capital budget through the inclusion of new projects, and expenditure reallocations. One of the main weaknesses in the budgeting process is that the MTFF is often revised during the parliamentary session to accommodate an expansion in the budget. The table below gives the indication of the changes that are made during the parliamentary sessions.

ii) Degree to which legislative procedures are recognized and respected

169. The legislature's procedures for budgetary review are established in the Law on the Parliamentary Session Procedures (2007 Articles 25.9.1-25.9.4) which are abided by. The budget has to go through 4 hearings at the parliament: i) the prime minister has to present the annual budget proposal at the plenary session of the parliament; ii) during the second hearing, all parliamentary standing committees, party and coalition caucuses, and the budget expenditure oversight sub-committee discuss the budget proposal with respect to their associated mandate, compile feedback and comments and submit them to the Budget Standing Committee. The Budget Standing Committee discusses all the comments and suggestions respectively, votes and submits its opinion to the plenary session of the parliament which in turn conducts open voting for each of the Standing Committee suggestions; iii) during the third hearing, the Budget Standing Committee revises the annual budget proposal by reflecting the comments and suggestions that got the majority votes during the second hearing of the plenary session, and prepares the final version of the annual budget proposal and submits it to the plenary session; iv) at the fourth hearing, the parliament speaker reads every article and provision of the budget, conducts a vote for each of them and gets the budget approved as a Law.

iii) Adequacy of the time for the Legislature to provide a response to budget proposals

170. As per the IBL (Article 8) the Government has to submit the budget to the parliament by October 1st and the parliament has to approve it by November 15th. For the 2013 and 2014 budgets, the Government submitted the budget on September 30th and October 1st respectively. Overall therefore, the parliament has approximately 6 weeks to approve the budget.

171. It should be noted that in the old budget legislation, namely the Public Sector Management and Finance Law of 2003, which was replaced by the IBL in 2011, the parliament had 2 months to debate the budget. This period was reduced in the IBL in order to give more time for the preparation of the detailed budget allotments after the budget's approval, and for the preparation of procurement plans given the need to contract projects in time for the start of the construction season.

iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature

172. The rules governing budget amendments are clearly specified in detail in the IBL (Articles 34 and 42). Any increase in government expenditures or reallocations between ministries (general budget governors) requires the government to submit a request for a supplementary budget to parliament. Specifically, Article 34 stipulates that a supplementary budget has to be approved by the legislatures if: (i) there is a suspension of the fiscal rules set in the FSL; (ii) revenue shortfalls result in an increase in the fiscal deficit of 3 percent of GDP; (iii) if there needs to be a reallocation of funds between general budget governors; and (iv) if capital expenditures increase due to a doubling of the cost of building materials as compared to the costs used in the original budget. Article 42 provides the authorities for in-year amendments by the executive. Line ministries can make adjustments between programs within their portfolio, and between the budgetary organizations that fall within their administrative jurisdiction (e.g. schools and hospitals in the case of the ministries of education and health respectively), but there can be no reallocations between capital and recurrent expenditures, nor can new programs and activities be financed.

Indicator	Score	Explanation	Information sources
PI-27 Legislative scrutiny of the annual budget law	**B+**	**M1 Scoring Method**	
i) Scope of examination by the Legislature	A	The parliament's review covers fiscal policies, the MTFF, and details of expenditure and revenue.	Budget Law, submitted and approved budgets.
ii) Degree to which legislative procedures are recognized and respected	A	The parliament's procedures for budget review, involving internal organizational arrangements, are firmly established by Law and are strictly abided by.	Law on the Parliamentary Sessions Procedures (2007)
iii) Sufficiency of time for the Legislature to respond to the budgetary proposals.	B	The 2013 budget is submitted by the executive on October 1st and approved by November 15th, giving the parliament 6 weeks to deliberate	The Budget Law; the submitted and approved 2013 budget.
iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.	A	Clear rules are specified in the IBL and they put strict limits on in-year budget amendments by the executive. These rules are always respected.	Budget Law Articles 34 and 42.

PI-28 Legislative scrutiny of external audit reports

173. As indicated in PI-26, although the annual budget execution reports and financial statements of central government entities at the portfolio ministers' (general budget governors') level are audited individually, until consolidated into the unified budget execution report and the consolidated financial statement of the Government, they are not required for submission to the legislature by law. Currently, Article 8.10.4 of the Integrated Budget Law of Mongolia mandates the Parliament to discuss the audited unified budget execution report in its spring session and then to approve the state budget execution. The amended Law on State Audit of 2013 (Article 16.3) also mandates the Budget Standing Committee of parliament to hold hearings on the results of audits conducted by MNAO that were proposed and ordered by the Parliament and make relevant decisions.

(i) Timeliness in examination of the audit reports by the Legislature (reports received within the past three years).

174. The key dates for the examination of reports received within the past three years were as follows:

- 2012 audited unified budget execution report: the report was submitted to parliament by the Government on June 7, 2013. The Parliament carried out the first hearing in its Plenary Session on June 27, 2013. After completing the first hearing, the Parliament requested the Standing Committees to carry out second hearings and report back in writing to the Sub-Committee on Budget Expenditure on any major issues for consideration and on whether or not the standing committee agrees to endorse the draft Parliament Decree on approving the budget execution. This decree was issued on July 4, 2013, less than 1 month after receipt of the audit reports.
- 2011 report: the report was received on June 8, 2012 and the decree was issued on October 24, 2012 or within 5 months of the receipt of the report. The reason for the delay was that 2012 was an election year (elections took place on June 28, 2012) and the decree was issued once the unified budget execution and the consolidated financial statements were discussed at the new Parliament.
- 2010 report: the report was received on April 20, 2011 and the decree was issued on July 9, 2011 or within 3 months of the receipt of the report.

(ii) Extent of hearings on the main findings undertaken by the legislature

175. As part of approving the 2012 budget execution per its mandate by the IBL (Article 8.10.4), the Parliament discussed the unified budget execution report, the consolidated financial statement of the Government and the relevant audit matters for the fiscal year. There were three hearings that took place in order for the Parliament to approve the budget execution. The first hearing took place on June 27, 2013 during a plenary session of the Parliament where both the Minister of Finance and the Auditor-General made relevant presentations followed by a question and answer session. Then the second round of hearings took place at the individual Parliamentary Standing Committee meetings on June 27-28, 2013. As the standing committee meetings were scheduled consecutively, the Minister of Finance and the Auditor-General were present at those meetings to present and respond to any questions. Some officials from Government ministries and agencies were also present at the relevant standing committee meetings to attend to any questions or comments. As a result of the second round of hearings, written responses and comments on the draft proposal of the Parliamentary decree to approve the budget execution were sent from the standing committees to the Sub-Committee on Budget Expenditure. As a result of a third hearing in a plenary session on July 3, 2013, the 2012 budget execution was approved and the Parliamentary decree was issued.

176. To conclude, in-depth hearings do take place on a routine-basis to the extent that Parliament is in its spring session. However, parliament has insufficient time to thoroughly review all audit findings and recommendations.

(iii) Issuance of recommendations by the Legislature and their implementation by the Executive

177. The MNAO sends to the Prime Minister the annual audit report containing the audited budget execution report, the audited consolidated financial statements of the Government and the audit findings and recommendations. The audit report is then reviewed by the cabinet ministers and discussed at a Cabinet meeting prior to being submitted to the Parliament. As required by Article 8.10.4 of the IBL, the Parliament reviews, discusses and approves the audit reports but there is no legal requirement for it to issue any recommendations based on its review. The 2013 audit report was approved by the parliament with no recommendations.

178. Despite this lack of direction from the Parliament, the MNAO does follow-up on its audit findings and has a sanctioning power of issuing fines and acts that obligate the relevant audited entities to comply in order to rectify the situation (LSA, Article 15.1.12). Evidence obtained shows most of MNAO's audit recommendations were implemented by the executive branch (e.g. 80% of the FY11 audit recommendations were fully implemented) and MNAO documents management responses to the findings in writing, analyzes the recommendations provided and keeps a record on the implementation progress of the recommendations.

Indicator	Score	Explanation	Information sources
PI-28 Legislative scrutiny of external audit reports	**D+**	**M1 Scoring Method**	
(i) Timeliness in the examination of audit reports by the Legislature (reports received within the past three years).	B	Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports.	IBL (Article 8), Law on State Audit (Article 16)
(ii) Scope of the hearings held by the Legislature into the main conclusions	B	In-depth hearings on key findings take place with responsible officers from the audited entities as a routine, but may cover only some of the entities, which received a qualified or adverse audit opinion.	

(iii) Measures recommended by the Legislature and implementation of these by the Executive	D	No recommendations are issued by the parliament	Parliamentary decree approving audit reports

Subsection 3.7: Donor Practices

D-1 Predictability of direct budgetary support

179. This indicator is not applicable as there has been no direct budget support in the last three fiscal years.

Indicator	Score	Explanation	Information sources
D-1 Predictability of direct budgetary support	**N/A**	**M1 Scoring Method**	
i) Annual deviation in real budgetary support with respect to that forecast by donor organizations at least six months before the Government presents its budgetary proposals to the Legislature (or other equivalent body responsible for approving the budget)	N/A	There has been no direct budget support in the last three fiscal years	Budget documents; Interviews with MoF and MED
ii) Timeliness of disbursements by donors throughout the year (fulfillment of aggregate quarterly estimates)	N/A	As above	

D-2 Financial information provided by donors for budgeting and reporting on project and program aid

i) Comprehensiveness and timeliness of donors' budgetary estimates in relation to project support

180. The IBL requires that a multi-year public investment program (PIP) be prepared that lists all prospective projects from various financing sources, including through donor financing. It also requires that the annual budget provides information on donor financed projects. In practice however, comprehensive and timely information of donor project support is not provided and is not included in the PIP or in the budget.

ii) Frequency and coverage of the presentation of reports by donors in relation to effective resource flows for project support

181. Grant financed projects are not included in the budget and therefore no information on disbursements of these projects is available to the Government. Disbursement information from loan financed projects from the largest donors (World Bank and Asian Development Bank) is made available within two months of the end of the quarter, but does not follow the budget classification system and is therefore not included in the budget reports.

Indicator	Score	Explanation	Information sources
D-2 Financial information provided by donors for budgeting and reporting on project and programme aid	**D**	**M1 Scoring Method**	
i) Comprehensiveness and timeliness of donors' budgetary estimates for project support	D	Not all major donors provide budget estimates for disbursement of project aid for the government's upcoming fiscal year.	Budget documents; Interviews with MoF and MED
ii) Frequency and coverage in the presentation of reports by donors on effective flows for project support	D	Grant financed projects are not included in the budget and no disbursement information for these is available to the Government. Disbursement information from loan financed projects from the largest donors is made available within two months of the end of the quarter, but does not follow the budget classification.	Budget documents; Interviews with MoF and MED

D-3 Proportion of aid managed by use of national procedures

i) Global proportion of aid funds to the central government that are administered on the basis of national procedures

182. None of the major donors are currently using country systems for the management of funds. Only the accounts of a select number of WB projects have been incorporated into the Treasury Single Account on a pilot basis, and the use of country procurement systems is under discussion for a select number of WB projects.

Indicator	Score	Explanation	Information sources
D-3 Proportion of aid managed by use of national procedures	**D**	**M1 Scoring Method**	
i) Proportion of aid funds for the central government that are managed in line with national procedures	D	None of the aid funds to central government are managed through national procedures	Budget documents; Interviews with MoF and MED, and selected donors

Section 4: Government reform Process

Subsection 4.1: Description of Major PFM Reforms

183. The Government of Mongolia has undertaken significant PFM reforms of the past decade. In many ways these reforms have followed the textbook "basics first" sequencing, with an emphasis in the period 2003-2008 on strengthening internal controls, cash management, and accounting and reporting, followed by the a focus since 2008 on improving fiscal policy, budget planning, and greater decentralization of expenditure responsibilities to local governments, as enshrined in the FSL and IBL detailed in Box 1 earlier.

184. Prior to 2003, the Mongolian public finance management system was fragmented and lacked operational fiduciary controls in budget execution.[11] There were more than two thousand bank accounts, operated by different agencies, and it was not possible to determine the Government's consolidated cash position at any point. The Government was borrowing overnight to meet expenditure needs as there was no consolidated single account, arrears were high, the accounting and reporting structure was fragmented across budget entities, and budget reports were consolidated with a lag of more than 3 months.

185. By 2007 significant improvements in budget execution, internal controls, and accounting and reporting had been accomplished. All accounts were consolidated in the TSA under the authority of the MoF, an operational treasury information system (the GFMIS) was in place with a country-wide electronic payment settlement system at the Bank of Mongolia, and budget reporting and accounting were harmonized using GFS 86 standards. These were remarkable achievements achieved in a relatively short period of time, and laid the PFM foundations for improved service delivery.

186. The second phase of PFM reforms also roughly coincided with Mongolia's resource boom with the discovery of large copper and coal deposits and the signing of the Oyu Tolgoi investment agreement in 2009. The 2008-2009 global financial crisis, and the resultant collapse of global mineral prices, hit Mongolia hard (and required an IMF program) and underlined the importance of a robust framework for fiscal policy and budget planning to avoid the well-known problems of the Dutch Disease. The FSL and IBL were landmark legislative achievements to address these weaknesses. The regulatory reforms, including greater transparency and accountability of public procurement laid out in the PPLM, the strengthening of the internal audit function, and greater fiscal decentralization also aimed at improving the quality of public spending and on ensuring that the benefits of the mining wealth were spread broadly across Mongolia.

187. Significant progress has also taken place in tax administration reforms since 2008. The General Taxation Law of 2008 provided the legal basis for tax administration operations and clarified rights and responsibilities of taxpayers and tax inspectors. The law reoriented tax administration from a framework based on enforcement to one centered on facilitating and promoting voluntary tax compliance through a tax self-assessment regime. The GDT was reorganized along functional lines, and a major effort is underway to develop an integrated tax administration information system to improve the efficiency and transparency of the entire tax administration cycle.

188. The period since 2012 has been turbulent, with reform reversals, and which underline the challenges inherent in a mineral resource dependent economy. The biggest step backwards has been the exponential increase in extra-budgetary financing of government spending through the DBM. This extra-budgetary spending — amounting to approximately 10 percent of GDP in 2013 — weakens the FSL and has created large macroeconomic vulnerabilities. It also hurts the quality of public spending as the expenditures are not reported in the budget, and do not follow competitive procurement procedures.

[11] See World Bank, 2008 Mongolia Public Expenditure Financial Management Report for details.

Subsection 4.2: Institutional Factors Supporting the Planning and Implementation of Reforms

189. The medium-term reform program is well understood by the MoF and is essentially the effective implementation of the FSL, IBL, and PPLM. The World Bank, IMF, ADB, the Swiss Agency for Development and Cooperation (SDC), the US Treasury Oversea Technical Assistance office, and Ministry of Finance of the Government of Korea have been providing technical assistance to the Government, especially the MoF, to this effect. The Bank has been engaged through two on-going technical assistance projects, grants from the Governance Partnership Facility, and analytical and advisory services. As a result of this support, a number of implementing regulations and procedures to support these laws have been developed, information systems for budget, tax, procurement, and debt management have been developed, and staff have been trained.

190. There are three major institutional factors however, that comprise the effective planning and implementation of these reforms.

191. First, the MoF's reform priorities are not shared by all concerned parties, in particular the MED. The MED, which was created in 2012, is politically the most powerful spending agency with responsibilities for both on-budget and off budget (the DBM reports to the MED) capital expenditures. There are fundamental disagreements between the MoF and MED on fiscal issues and weak coordination in budget preparation.

192. Second, an underlying constraint has been the implementation gap between the laws and the capacity of the key agencies to implement these laws. The MoF is small, with a staff of approximately 150, and while the technical abilities of this staff has been steadily improving there are significant staff shortages in a number of areas such as estimation of fiscal risks, revenue forecasting, intergovernmental fiscal relations, oversight of the financial sector, procurement policy, and internal audit. Similarly while the legal structure for external audit is strong, the MNAO is also understaffed and lacks the capacity to effectively conduct performance audits. Most significantly, the rapid expansion in capital spending has greatly stretched the limited capacity of the MED to effectively plan and appraise projects, and of the Government Procurement Agency, which was only formed in 2012, to efficiently procure these contracts, which risks to value for money.

193. Third and most importantly, are the underlying political economy factors that have weakened the formal PFM system. The parliament of Mongolia is very powerful and exercise considerable authority over fiscal policy and budgeting, as measured in the high score for PI-27. All too often however, this formal authority has been exercised in ways that undermine fiscal sustainability (through overly optimistic revenue forecasts), allocative efficiency (through budgetary amendments that introduce new spending items that have not gone through the normal budgetary procedures), and efficient service delivery (through the excessive use of direct contracting for capital projects).

194. The strength of Mongolia's political system, and society, is openness, not just of fiscal and budget transparency, but of the broader political process, with active citizen engagement in a variety of dimensions. The Government has undertaken a number of measures to institutionalize citizen participation, which include becoming a member of the international Open Government Partnership, passing a Right to Information Act (2012), formalizing participatory budgeting in the IBL, and formalizing citizen monitoring of procurement in the PPLM. Transparency and citizen engagement can gradually help to align the informal institutions with the formal PFM institutions to better achieve fiscal sustainability, strategic allocation of resources, and efficient service deliver so that Mongolia's vast mineral resources can be used to better the lives of its citizens.

ANNEXES

Annex 1: Detailed score calculations

A. PFA RESULTS: Credibility of Budget					
Indicator/method	***Score***	***D (i)***	***D (ii)***	***D (iii)***	***D (iv)***
PI-1 (M1)	***D***	D	--	--	--
PI-2 (M1)	***C+***	C	A	--	--
PI-3 (M1)	***D***	D	--	--	--
PI-4 (M1)	***C***	C	C	--	--
B. KEY CHARACTERISTICS OF ALL STAGES: Comprehensiveness and transparency					
PI-5 (M1)	***C***	C	--	--	--
PI-6 (M1)	***A***	A	--	--	--
PI-7 (M1)	***D+***	D	C	--	--
PI-8 (M2)	***A***	B	A	A	--
PI-9 (M1)	***C+***	C	A	--	--
PI-10 (M1)	***A***	A	--	--	--
C. BUDGETARY CYCLE					
C (i) Policy-based budgeting					
PI-11 (M2)	***A***	B	A	A	--
PI-12 (M2)	***C***	C	A	D	D
C (ii) Predictability and control in budget execution					
PI-13 (M2)	***B***	B	A	C	--
PI-14 (M2)	***C+***	C	B	C	--
PI-15 (M1)	***C+***	C	A	A	--
PI-16 (M1)	***D+***	D	D	C	--
PI-17 (M2)	***C***	C	B	D	--
PI-18 (M1)	***D+***	D	D	B	C
PI-19 (M2)	***D+***	B	D	C	D
PI-20 (M1)	***D+***	D	B	B	--
PI-21 (M1)	***C+***	B	C	C	--
C (iii) Accounting, recording and reporting					
PI-22 (M2)	***B+***	A	B	--	--
PI-23 (M1)	***A***	A	--	--	--
PI-24 (M1)	***C+***	C	A	C	--
PI-25 (M1)	***C+***	B	A	C	--
C (iv) External scrutiny and audit					
PI-26 (M1)	***B+***	B	B	A	--
PI-27 (M1)	***B+***	A	A	B	A
PI-28 (M1)	***D+***	B	B	D	--
D. DONOR PRACTICES					
D-1 (M1)	***NA***	NA	NA	--	--
D-2 (M1)	***D***	D	D	--	--
D-3 (M1)	***D***	D	--	--	--

NR-non scored ***NA***-does not apply

Annex 2: Overview of performance indicators with brief explanation and sources

	A. PFA RESULTS: Credibility of Budget	Score	Brief explanation & evidence
PI-1	Aggregate expenditure out-turn compared with original approved budget	*D*	Calculation for budget outturns is based on the budget data available on (www.lltod.gov.mn)
PI-2	Deviations of budgetary expenditure in comparison with original approved budget	*C+*	Same as above
PI-3	Deviations in aggregate revenue out-turn compared with original budget	*D*	Same as above
PI-4	Stock and monitoring of expenditure payment arrears	*C*	Data on expenditure arrears received from the Treasury Department, the Fiscal Policy and Planning Departments
	B. KEY FEATURES AT ALL STAGES: Comprehensiveness and transparency		
PI-5	Budgetary classification	*C*	Law of Mongolia, Budget Law, December 23rd, 2011; MOF, Budget Classification Document (2013); Budget for FY 2013
PI-6	Comprehensiveness of information included in budgetary documentation	*A*	IBL 2011; 2014 Budget
PI-7	Extent of unreported government operations	*D+*	DBM, Budget documents, Law on Coordination and Management of Foreign Aid
PI-8	Transparency of inter-governmental fiscal relations	*A*	www.mof.gov.mn
PI-9	Oversight of aggregate fiscal risk caused by other public sector bodies	*C+*	IBL, budget execution reports. Interviews with MOF staff.
PI-10	Public Access to key fiscal information	*A*	Budget Law (2011) MOF, Ministry of Health, Ministry of Education and Science www.mof.gov.mn; www.audit.mn www.parliament.mn; www.e-procurement.mn Regulation for enabling transparency of budget and finance (Government Decree approving the regulation of January 18, 2012) General regulation for information transparency (Government Decree approving the regulation of December 14, 2014)
	C. BUDGETARY CYCLE		
	C i) Policy-based budgeting		
PI-11	Orderliness and participation in annual budget process	*A*	Budget Law 2011; Government Resolution ref 228 about approving 2014 fiscal ceilings for General Budget Government (June 26th, 2013); General Guidelines to prepare 2014 budget proposals for general budget government (July 9, 2013); Budget Law of Mongolia for 2012, 2013 & 2014

PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	*C*	Fiscal Stability Law (2010); Budget Law (2011) MTBF baseline for 2012-2014; MTBF baseline for 2013-2015; Government Action Plan (2012-2016); MOF, MED; www.med.gov.mn IMF, Mongolia-Staff Report for the 2013 Art. IV Consultation, November 5, 2013; IMF, Mongolia-Staff Report for the 2012 Art. IV Consultation and Post Program Monitoring, November 29, 2012; IMF, Mongolia-Staff Report for the 2011 Art. IV Consultation, March 30, 2011; www.imf.org MOF, MED, Ministry of Education and Science, Ministry of Health, Ministry of Roads and Transportation; Government Action Plan (2012-2016) Education Policy, Annex 1 to the Decree no A24 issued by the Ministry of Education and Science (20 September 2012) Action Plan for Education Policy, Annex 2 to the Decree no A24 issued by the Ministry of Education and Science (20 September 2012)
	C ii) Predictability and control in budgetary execution		
PI-13	Transparency of taxpayers' obligations and liabilities	*B*	General Taxation Law, interviews with MoF Revenue Division, GDT Tax Collection Department, and Mongolia National Chamber of Commerce; www.mta.mn; General Taxation Law (Article 19.3); consultant report; interviews with GDT and MoF Revenue Division staff.
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	*C+*	Interviews with staff of the GDT; General Taxation Law (Articles 74 and 75); Interviews with GDT Tax Collections Department; Data from GDT Tax Audit Department; interviews with GDT and Chamber of Commerce
PI-15	Effectiveness of tax collection	*C+*	Data from the GDT Collections Department; Interviews with staff of the GDT Collections Department and MoF Treasury Department
PI-16	Predictability in the availability of funds for commitment of expenditure	*D+*	Interviews with staff of MOF; IBL Articles 34 and 42
PI-17	Recording and management of cash, debt and guarantee balances	*C*	Interviews with staff of the Debt Management Division; Interviews with staff of the Treasury Department
PI-18	Effectiveness of payroll controls	*D+*	Interviews with staff of MOF, CSC, MOE, schools, and primary health centers; Interviews with staff of MNAO
PI-19	Competition, value for money and controls in procurements	*D+*	www.e-procurement.mn PPLM
PI-20	Effectiveness of internal controls on non-salary expenditure	*D+*	Treasury (MOF), Budget Law (2011)
PI-21	Effectiveness of internal audit	*C+*	MOF, MNAO
	C iii) Accounting, recording and reporting		
PI-22	Timeliness and regularity of accounts reconciliation	*B+*	MOF, MNAO
PI-23	Availability of information on resources received by service delivery units	*A*	2013 Budget and budget execution reports; Interviews with select primary school and primary health center staff

PI-24	Quality and timeliness of in-year budget reports	***C+***	Budget execution reports on MOF website (www.mof.gov.mn). PI-5 and IMF, Report by Arun Kumar Srivastava (November 2013).
PI-25	Quality and timeliness of annual financial statements	***C+***	IBL (Article 26), Accounting Law (Article 10)
	C iv) Scrutiny and external audit		
PI-26	Scope, nature and follow-up of external audit	***B+***	IBL
PI-27	Legislative scrutiny of the annual budget law	***B+***	Budget Law, submitted and approved budgets. Law on the Parliamentary Sessions Procedures (2007). The Budget Law; the submitted and approved 2013 budget. Budget Law Articles 34 and 42.
PI-28	Legislative scrutiny of external audit reports	***D+***	IBL (Article 8), Law on State Audit (Article 16) Parliamentary decree approving audit reports
	D. DONOR PRACTICES		
D-1	Predictability of direct budgetary support	***NA***	--
D-2	Financial information provided by donors for budgeting and reporting on project and programme	***D***	Budget documents; Interviews with MOF and MED
D-3	Proportion of aid managed through use of national procedures	***D***	Budget documents; Interviews with MOF and MED, and selected donors

NS-non scored   NA-does not apply