

VI. Government Budgeting and Accounting

This chapter describes government budgeting and accounting arrangements. For the purposes of this report, government is defined as central government organizations, local government organizations, and not-for-profit (NFP) organizations.⁶¹ In line with PRC criteria, state-owned enterprises (SOEs) are covered elsewhere along with private-sector organizations. The chapter is structured as follows:

- 1 – Introduction
- 2 – The Budget Cycle
- 3 – Legal Framework for Budgeting and Accounting
- 4 – Budgeting Roles and Responsibilities
- 5 – Accounting Bases
- 6 – Financial Reporting
- 7 – Budgeting and Reporting Developments
- 8 – Anti-Corruption Measures

1. Introduction

In the past 20 years, the PRC's fiscal deficit has remained comparatively low and the country has made impressive progress in terms of economic and social outcomes. Among other things, the ability of the PRC's economy to continue to deliver improved outcomes depends on how well it manages public expenditures.

In common with other centrally-planned economies that are transiting to a mixed-market economy, the PRC's immediate focus has been on improving financial management arrangements for profit-oriented organizations. Given the scope of this task, it is not surprising that reforms to governmental financial management arrangements have been accorded a lower priority. That said, several issues have focused attention on governmental financial management arrangements in the past five years.

First, a growing body of economic literature supports strong linkages between government effectiveness and development outcomes.⁶² Second, local governments have limited authority to impose taxes, but central government transfers are generally inadequate to cover

⁶¹ Not-for-profit organizations include schools, kindergartens, and hospitals. The PRC does not consider these as government organizations.

⁶² See, for instance: Kaufmann, Daniel, Aart Kraay and Pablo Zoido-Lobaton. 1999. *Governance Matters*, Working Paper: The World Bank.

expenditures. Local governments bridge the resulting gap with extra-budgetary funds (surtaxes, levies and user charges accruing to government and administrative units).⁶³ The inter-governmental fiscal arrangements associated with this situation are almost universally recognized as unsatisfactory and are perhaps the major cause of corruption amongst public officials. Third, there is growing identification of public sector wastage and mismanagement.

In recognition of these issues, the MOF, with support from the UNDP, the World Bank and the IMF, is currently examining options for budgetary reform with the intention of designing a comprehensive program to overhaul the PRC's budget procedures.

2. The Budget Cycle

Figure 5 presents the indicative budget cycle as it currently stands. Note that spending ministries and units are not advised of their approved budgets until well into the year.

Figure 5: The Budget Cycle

Budget Stage	Month	$t-1$	Budget year (t)	$t+1$
I. Budget Preparation				
State Council orders drafting of the Budget and sets out broad guidelines for the draft	Oct - Nov	■		
Spending units, ministries and local government units compile their draft budgets, which they submit to MOF sectoral departments.	Oct - Dec	■		
MOF consults with ministries and local governments on budgets	Nov	■		

⁶³ See, for instance:

- Wong, Christine, Christopher Heady, and Wing Woo. 1995. *Fiscal Management Reform in the People's Republic of China*: Asian Development Bank.
- Arora, Vivek B., and John Norregaard. (1997). *Intergovernmental Fiscal Relations: The Chinese System in Perspective*. IMF WP/97/129-EAWP/97/129.

GOVERNMENT BUDGETING AND ACCOUNTING

Budget Stage	Month	<i>t-1</i>	Budget year (<i>t</i>)	<i>t+1</i>
MOF drafts the central budget and compiles the state budget	Nov - Dec			
MOF submits the budgets to the State Council for discussion	Jan			
MOF presents draft budget to the Finance and Economics Standing Committee of the NPC	Feb			
Finance Minister presents budgets to the NPC	Mar			
MOF passes on approved budgets to spending ministries	Mar - May			
Spending ministries pass on budgets to spending units	Mar - May			
II. Budget Implementation				
Spending takes place	Jan - Dec			
III. Reporting and Audit				
CNAO audits spending units' accounts	Jan - Mar			
Finance Minister presents preliminary final accounts to NPC	Mar			
CNAO audits central accounts	Jan - Apr			
Finance Minister presents final accounts to the NPC Standing Committee	Jun - Jul			

3. Legal Framework for Budgeting and Accounting

The *Budget Law 1994* (effective from 1 January 1995) governs budgeting. It specifies budget roles and responsibilities, the budget process and the limits of the budget entity. Governments at different levels manage budgets separately – there are altogether five levels of budgets from the central level downwards. The *Accounting Law 1985* and the associated *Government Uniform Accounting System* govern accounting and reporting arrangements for government organizations.

4. Budgeting Roles and Responsibilities

The MOF and local government finance bureaus prepare the central budget and local budgets as well as final accounts. They are also responsible for the implementation and preparation of budget-adjustment plans. The State Planning Commission (SPC) and the People's Bank of China (PBC) have prime responsibility for macroeconomic forecasting. Furthermore, the SPC prepares a rolling five-year investment plan. Macroeconomic forecasting, fiscal forecasting, investment planning, and budget preparation are inextricably intertwined, but the level of consultation between the MOF, the PBC and the SPC does not reflect this.

5. Accounting Bases

The aggregate budget is prepared on a cash basis. The Government also prepares a consolidated balance sheet that includes information on the level and composition of debt. This information is provided in publications, such as the China Statistics Yearbook. Individual budget units use modified cash accounting. Their reports include cash information that is consolidated for aggregate budgeting and reporting requirements.

Not-for-profit organizations (e.g., schools, kindergartens, hospitals) have recently moved from cash accounting to a modified form of accrual accounting.

6. Financial Reporting

The uniform accounting system for Government organizations sets out reporting requirements. The central treasury reports daily, monthly and annually to the MOF – daily and monthly reports consist of aggregate

numbers on revenues, expenditures and account balances. Spending units report monthly and annually to supervising ministries, which compile reports to the MOF. Table 11 presents details of the external financial reports prepared by public sector organizations. There are no set requirements for internal financial and performance reports.

Table 11: Financial Reports

Type of Organization	Composition of Financial Statements
Government Agencies	<ul style="list-style-type: none"> ○ Balance sheet ○ General statement of revenues and expenditures ○ Detailed breakdown of expenditures, and ○ Explanations.
Not-for-profit Organizations	<ul style="list-style-type: none"> ○ Balance sheet ○ Statement of revenues and expenditures ○ Statement of investment in basic construction ○ Supplementary statements ○ Notes ○ Detailed breakdown of expenditures, and ○ Explanations
Public Financial Institutions	<ul style="list-style-type: none"> ○ Balance sheet ○ Report against budget (the statement of budget implementation) ○ Explanation of activities, and ○ other supplementary statements.

7. Budgeting and Reporting Developments

A project to reform budget arrangements was initiated in 1998 in Hebei province. The project will alter the timing and focus of the budget process, and make budget reports more comprehensive. The MOF is in the process of developing plans for computerizing government budgeting and reporting. These changes may also include cash management reforms, the introduction of a Single Treasury Account, and the reformation of reporting classifications.

There are currently no firm plans for government organizations to report in accordance with International Standards. However, a research study into the feasibility of developing accounting standards for

government organizations will be conducted as part of the *Accounting Reform Project* (chapter VII refers).

8. Anti-Corruption Measures

The Government launched a campaign against corruption, embezzlement, and illegal use of funds in 1998, which continued in 1999. The Anti-corruption Conference of the State Council in January 1999 confirmed the anti-corruption drive as one of the Government's top priorities. The Government intensified measures to fight corruption, introducing measures to abolish affiliations between Government and business, and the military and business. There is an ongoing campaign to inspect public works and to hold officials personally accountable for shoddy construction, misallocation of funds and corruption. In June 1999, the Government announced that it would tighten regulation of the central budget and set up a body to punish corrupt officials based on strict auditing. The new auditing rules that have been adopted in this respect require that officials at the national level and below, as well as the senior managers of SOEs, be audited after the person is dismissed, resigns, or retires.

The Government has also recognized that the use of transparent bidding processes can help to create an environment that will reduce the opportunities for corruption. The *Tendering and Bidding Law 1999*, mandates transparent public bidding for large infrastructure projects, and projects involving loans or aid funds from international organizations or foreign governments. A *Government Procurement Law* is included in the legislative work program.