

RISK ASSESSMENT AND RISK MANAGEMENT PLAN (SUMMARY)¹

I. KEY ISSUES

1. The governance risk assessment was conducted to inform the country partnership strategy for the People's Republic of China (PRC), 2016–2020. The assessment covers three areas: public financial management, procurement, and anticorruption. The risk assessment and risk management plan is based on the country governance risk assessment report and sector governance risk assessment reports covering the sectors of education and environmental protection.

A. Public Financial Management

2. **Budgetary system.** To further improve budget management, the Ministry of Finance in 2012 issued instructions to local governments to have all-inclusive comprehensive budgets by 2015. The new budget law of 2014 requires all levels of government revenues and expenditures to be consolidated under one budget. Further, any modification to budgets needs to be reflected in the plan of budget adjustment. The new law also addresses the issue of local government debt by letting provincial governments issue bonds within a quota set by the State Council and approved by the National People's Congress or its standing committee. The Third Plenum in 2013 reinforced major reform measures that lead to inclusive and sustainable growth, rebalancing of incomes and strengthening consumption, moving up the value chain, and environmental protection.

3. **Expenditure management.** The centralized payment processing system and the standardized budgetary system are examples of major improvements in expenditure management. Important initiatives already implemented include the strengthening of information management systems, the adoption of medium-term expenditure frameworks, performance budgeting, and the tightening of cash management through the development of the treasury single account system.

4. **Public financial management risks.** Overall, the PRC has strong financial management legislation, structures, and systems in place, which have been further reinforced in recent years and aligned with international standards. Major risks remain only where subprovincial levels are lagging behind in the implementation of reforms in core functional areas of financial management, i.e., accounting and reporting, accrual accounting and risk-based control, and internal audit. The lack of capacity at subprovincial level may both hamper effective financial control and constrain the shift of focus from controlling inputs to managing results.

B. Procurement

5. **Procurement legislation.** The PRC has instituted laws and regulations governing public sector procurement that reflect its transition towards a market-based economy. The laws are based on international best practices and principles, require the use of competitive bidding as the main procurement method, define the conditions under which other procurement methods can be applied, and have articles dealing with corrupt practices. The Implementing Regulation on the Tendering and Bidding Law came into force on 1 February 2012. The regulation encompasses a standardized and more transparent system, and addresses concerns over

¹ This summary is based on an assessment of public financial management, procurement, and corruption systems at the country and sector levels.

malpractice and collusion. The Tendering and Bidding Law covers general procurement activities, including government agencies, the private sector, and individuals. New regulations on implementing the Government Procurement Law became effective on 1 March 2015 and cover government procurement activities.

6. **Procurement in Asian Development Bank projects.** Procurement in projects in the PRC financed by the Asian Development Bank (ADB) has generally complied with ADB guidelines.² ADB has developed standard documents for use in international competitive bidding, while the national standard can be applied for national competitive bidding. Based on ADB's 10 Point Action Plan on Procurement Reform, more robust risk assessment allows for increasing national competitive bidding and provides more authority to the executing agencies in approving procurement transactions. On occasion, ADB procedures have not been strictly followed. These instances have included failure to report the procedures followed for invitation of bids, in seeking ADB approval for amendments to bidding documents subsequent to their issue, or incorrect or unnecessary evaluation criteria or misapplication in bid evaluation procedures.

7. **Procurement risk.** At the provincial level, entry barriers for suppliers from beyond provincial boundaries may render policies to increase productivity and innovation less effective. Provincial governments tend to create policies favoring local suppliers, such as requesting a registered office in the province, so as not to lose the job and tax opportunities in the province. Another risk is that an ambiguous tender specification may lead contractors to take advantage of the need to revise the specification during implementation to inflate the cost.

C. Anticorruption

8. **Anticorruption legislation.** The PRC has promulgated extensive laws and regulations on construction of government that is transparent and free from corruption. Local governments at all levels have developed corresponding regulations and rules. Ministries and provincial departments have also issued documents to regulate the behavior of officials. In December 2010, the PRC published *Efforts to Combat Corruption and Build a Clean Government*,³ which for the first time provided a comprehensive summary of anticorruption practices in the PRC in terms of the legal system, institutional development, and prevention measures. The government is also taking steps to mobilize the public and seek out fraud and corruption, making it easier to report suspicions as well as strengthening discipline inspections and prosecutions.

9. **Asset declaration.** In 2014, the PRC started implementing a registration system for real estate and stock ownership of civil servants. The authorities announced that there would be spot checks, with strict checks on the real estate and stock ownership every time an official is promoted. Rules requiring PRC nationals to declare their foreign assets and debt came into effect on 1 January 2014. Under new rules regarding international receipts and payments, introduced by the State Administration of Foreign Exchange, citizens and organizations in the PRC, as well as foreign individuals and organizations that conduct businesses in the PRC, need to file reports on overseas financial assets and liabilities.

10. **Integrity and transparency of the public procurement system.** The PRC has enacted measures to prevent corruption and promote integrity amongst officials undertaking

² ADB. 2015. *Procurement Guidelines*. Manila; ADB. 2013. *Guidelines On The Use Of Consultants*. Manila.

³ Information Office of the State Council of the People's Republic of China. 2010. *White Paper on China's Efforts to Combat Corruption and Build a Clean Government*. Beijing.

procurement, including (i) specific provision under the Government Procurement Law prohibiting officials and staff from receiving illegal benefits or accepting bribes, gifts, and hospitality; (ii) requirements for local governments and procurement regulatory authorities to conduct a performance review system for procurement personnel; (iii) rotation of procurement officials to prevent fostering relationships with contractors and suppliers resulting in favoritism; (iv) and prohibiting bidders from bribing public officials.

11. **Corruption risk.** Although strict laws against corruption are in place, there are still some challenges in implementation. Corruption is being treated in the vast majority of cases by Communist Party of China disciplinary organs. Only a fraction of cases are submitted to the state judicial organs for prosecution. Detecting acts of corruption or corruption-related activities such as money laundering requires that government agencies systematically share data without bureaucratic hurdles. The insufficient exchange of data between government agencies (e.g., tax offices, customs, National Bureau of Corruption Prevention, etc.) may slow down or hamper the fight against corruption.

II. RECOMMENDATIONS

12. **Strengthen public financial management capacity at subprovincial levels.** ADB should reinforce ongoing support in assessing and strengthening public financial management capacity at subprovincial levels, e.g., through promoting skills training (accounting and reporting), knowledge sharing (accrual accounting and risk-based internal control), and organizational reviews (internal audit). ADB should provide technical assistance and support training activities to finance staff in local authorities and project officers and extend support in strengthening the use, quantity, and quality of management through policy advice and technical assistance.

13. **Reconcile procurement policies.** Possible reforms in protectionism at the local level would require a systematic approach, especially when it comes to less-developed provinces. This is an area where ADB and the government could work together to ensure that an approach is devised that gives adequate consideration to both national and subnational concerns. To mitigate the risk of inflated costs arising from ambiguous tender documents, ADB should provide technical assistance in developing robust tender specifications and contractual details and strengthening capacities for evaluating tendering documents.

14. **Facilitate data exchange between government agencies for better anticorruption measures.** To address the risks arising from corruption, ADB should support studies reviewing the need and possibilities for enhanced data exchange between government agencies. ADB should also support systematic reviews of the forms and perception of corruption, and develop appropriate recommendations assisting government in its efforts to curb corruption.