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# Government Auditing in China

BY J. STEPHEN NOM LEE

In view of the scarcity of literature about China's government auditing system, one may be astonished to hear of the existence of a modern system of government auditing in the administration of the government finance in China. Yet when comparing the different constitutions with other countries, one finds the Chinese constitution emphasizes auditing more than other constitutions do.

Few people realize that government auditing was practised in China as early as the time when King Hammurabi founded the first Babylonian empire. Even at that time there was a strong desire among the governing authorities to make auditing a compulsory measure in government administration, and a clear distinction was made between government auditing and private auditing. It is the purpose of this article, therefore, to throw some light to the English speaking people on the present system of government auditing as practised in China today.

## HISTORY OF CHINESE GOVERNMENT AUDITING

In early Chinese history, auditing involved nothing more than checking the accuracy of account figures, yet more importance was placed in government auditing than government accounting.

Some kind of an auditing system was known as far back as King Yu of Hsia dynasty\* in 2205 B. C. National revenues and expenditures, in his reign, were audited with great care. Unfortunately, there were no written materials or complete records preserved for present references. The system was simple and inadequate to be sure, but there was revealed a serious effort, on the part of the governing authority, to have some controlling control over the administrators of public finance.

During the Han dynasty, in 206 B. C., auditing began to assume an important rôle in public administration. All accounting officers of different government organizations in the country, as a result, were required to go to the national capital to make their annual reports in person. Communications between the capital and the different provinces in those days were very trying and difficult, as was to be expected, but in spite of that fact, the system was carried out satisfactorily.

\* See "Chinese Auditing System," by Lou Wan Ting, *Chinese Accounting Quarterly*, vol. 1, no. 4.

During the reign of Emperor Hsien, in 73 B. C., the importance of government auditing seemed to dwindle because of the passive attitude of public officers. Auditing was indifferently carried out. Frauds and falsified accounts, naturally, assumed a very serious magnitude. The government, however, finally realized the seriousness of the effect of fraud upon public accounts, and legislation, which authorized the appointment of officers to audit the books and records of different government organizations of different provinces was passed. According to this law, the financial officer would be severely dealt with if his financial reports were not made in accordance with the rules and procedure prescribed. This, then, was really the foundation of government auditing in China.

As Chinese civilization progressed, the system of government auditing also improved. During the Tang dynasty, 618 A. D., a bureau of audits was created. This bureau had to do with the checking and verification of all financial transactions, all receipts of revenues and all military expenditures and salaries of government officers, etc. This bureau, fortunately, was not directly under the department of finance but was under the judicial department. The idea of placing the bureau of audits away from the influence of the department of finance was well conceived, because it served as a check against the department of finance, which in those days was the most powerful department of the government and had most to say in the administration of national revenues and expenditures.

Down to the Sung dynasty, 960 A. D., the system of auditing passed through a tremendous change. Auditing became, then, a very important function in government reform. A new system of government was introduced, in which the "yuen" (branch) system was adopted in government administration. One of the "yuens" (six in all) was the auditing "yuen," the sole purpose of which was the supervision and auditing of all national revenues and expenditures. It was in this period that the present "yuen" system of government administration arose. At the same time, government auditing was given the most encouragement and the widest power to carry out its various activities.

During the reign of Emperor Lung Hsin (1490-1560), the scope of auditing was very much enlarged and the application of audit rules was more intensively carried out. During this period, civil wars were rampant all over the country. Military expenditures

had reached such a staggering amount that an unprecedented drain of silver reserves from the national treasury took place. An audit, consequently, was instituted to investigate the accounts of the department of finance. All receipts and expenditures of different provincial administrators of the country were also given close scrutiny. Some bookkeeping forms and reports were introduced, for the first time perhaps, in order to facilitate the work of auditing. It is interesting to note that during Emperor Lung Hsin's reign, Paciolo, father of modern accounting, published his famous treatise, in 1494.

Down to the Tsing dynasty, 1644, the system of government administration was different from that of former reigns. Instead of having an auditing "yuen" as in the case of the former Sung dynasty, a department of audits was created by law to take care of the auditing of public accounts of different government organizations in the country; but, for some reasons or other, the organization of the department of audits had never materialized. The work of the department of audits was then taken up by one of the departments of the ministry of finance.

In the last days of the reign of the empress dowager, 1908, the former auditing "yuen" or department of audits was totally disregarded. No attempt was made to improve government auditing. Auditing of public accounts was taken up by the ministry of finance instead of by an independent organization as it was formerly. Auditors were appointed by the ministry of finance to different provinces to oversee all accounts and transactions relative to national revenues and expenditures. Those auditors were given authority to adjust or to correct on the spot any irregularity of accounts and to report to the ministry of finance in case of frauds or illegal entries found during the course of audit. The significance of auditing as an independent check against administrators of public finance of the government was much diminished, however.

But in 1910, during the reign of Emperor Hsin Tung, the boy emperor of China, the former "yuen" system of government administration, which originated in the Sung dynasty, was restored. It is gratifying to note that one of the "yuens" was the auditing "yuen." During this new reign, one of the laws of audit specified that the auditing "yuen" must appoint qualified auditors immediately to audit all accounts of the ministry of finance and also all accounts of the different provinces. But

before the actual organization of the auditing "yuen" took place, the law specified that, as a temporary measure, such audits were to be taken up by a high officer, in the case of the ministry of finance, and by governors, in the case of provinces. It is thus clearly seen that government auditing was very seriously considered under the boy emperor's régime. Unfortunately, the national revolution broke out. The boy emperor was dethroned and the system was not carried out.

After establishment of the republic in 1911, the constitution, under the new régime—or what was commonly described as the "Peking government"—definitely specified that a bureau of audits was to be created, with sub-bureaus throughout all provinces of China. A set of audit rules was promulgated. Unfortunately, there was a serious objection to this form of organization, because of the fact that this bureau, according to the constitution, was directly under one of the cabinet ministers, and therefore, could not function independently as a supervisor of administration of national finance. This defect was, however, corrected when, in 1914, new legislation was passed to enlarge the bureau of audits and to raise its status to that of the auditing "yuen" in order to have it placed directly under the president of the republic. The main functions of the new auditing "yuen" had to do with the audit of national revenues and expenditures and the verification of receipts and disbursements reports submitted by different government organizations of the country. This system worked out quite satisfactorily in spite of chaotic conditions in China at the time.

In 1927, however, after Generalissimo Chiang Kai Shek made a successful drive against the "Peking government" and removed the national capital from Peking (now renamed Peiping) to Nanking, political conditions in China as a whole began to show much stability. Good progress has been made toward political, financial and economic consolidation. A year later, in 1928, the auditing "yuen" was reorganized and was placed directly under the nationalist government, whose chief executive officer was, and still is, the chairman instead of the president. In effect, the auditing "yuen" was placed directly under the chief executive officer of the republic.

In 1929, the nationalist government was reorganized. The five-"yuen" system of government administration was adopted. The auditing "yuen" was changed to the ministry of audits,

which was placed directly under the control "yuen." A law on uniform procedure for auditing of government accounts was enacted and carried into effect two years later. In 1933, there was a slight change of this new law, according to which the ministry of audits was authorized to establish a bureau of audits in every province of China. These bureaus are directly under the control of the ministry of audits, and, therefore, constitute the latest stage of the evolution of the Chinese government auditing the organization and procedure of which I shall now describe briefly in the following paragraphs.

#### ORGANIZATION OF THE MINISTRY OF AUDITS

According to the law promulgated by the nationalist government on October 29, 1929, the ministry of audits is directly responsible to the control "yuen." The head of the ministry of audits is known as the auditor-general, under whom are two assistants known as assistant secretary and under-secretary respectively, two to four general secretaries; nine to twelve auditors; twelve to sixteen assistant auditors, and, eight to eighteen inspectors.

The labors of the ministry of audits are delegated to three divisions which are placed under the responsibility of three senior auditors, besides a general affairs division which is in charge of one of the senior secretaries.

The first division of the ministry of audits has to do with the audit of the budget of the nationalist government and all budgets of government organizations in the country and also the authorization of treasury warrants. It has, therefore, a definite responsibility as to the pre-audit examination of the administration of national finance.

The second division of the ministry of audits, on the other hand, has to do with the audit of settlement (final) accounts submitted by different organizations of the government, including the ministry of finance. In other words, it has a definite responsibility as to the post-audit examination of the administration of national finance.

The third division of the ministry of audits supplies a connecting link between the first and the second division. This division sends traveling auditors and inspectors to every government organization of the country for field audits and special audits. They have the power to inspect all books and evidence of every government organization in the country.

The last division of the ministry of audits takes charge of general affairs of the ministry itself—namely, correspondence, official documents, accounts of the ministry, etc. In other words, it is an executive office for the ministry.

Beside the divisions described, the ministry of audits has also a bureau of audits in each of the provinces. These bureaus are organized mainly to facilitate the auditing of provincial accounts, as it would save a great deal of trouble and time if provincial accounts were to be sent to the various bureaus instead of to the ministry. The organization of the bureaus is somewhat similar to that of the ministry, except, of course, on a much smaller scale.

In short, the main functions of the ministry of audits are to audit government's annual accounts, monthly receipts and disbursements of all government organizations, special grants and items of different government organizations and their statements of official properties, materials and supplies.

The ministry of audits also makes reports to the nationalist government on:

- (1) Reconciliations of treasury disbursements with settlement accounts of different organizations;
- (2) Receipts, employment of funds, sale or transfer or use made of official properties, materials and supplies and the corresponding budget figures;
- (3) Payments made in excess of budget figures or payments made not otherwise provided by budget estimates;
- (4) Results of the annual fiscal period, with suggestions or recommendations on desirable legislative or administrative changes.

#### AUDITING PROCEDURE

Since adoption of the "Uniform system of government accounting in China" \* in 1931, all budgets of government organizations have been made by the department of budgets, accounts and statistics and have been approved by the legislative "yuen." Every government organization must submit its budget to the bureau of budgets of the department of budgets, accounts and statistics for presentation to the legislative "yuen" for approval; after which, the first division of the ministry of audits will authorize the ministry of finance to issue treasury warrants in accordance with approved budgets. No warrants will be paid by

\* See "Government Accounting in China," *THE JOURNAL OF ACCOUNTANCY*, vol. LXI, no. 4.

the ministry of finance without proper authorization by the ministry of audits. At the end of the budget period, each organization must submit its settlement accounts (final accounts) to the second division of the ministry of audits for its final audit.

A settlement account in the case of general government organizations consists of:

- (1) A budget of estimated revenues;
- (2) A budget of estimated expenditures;
- (3) A statement of actual revenues collected;
- (4) A statement of actual expenditures;
- (5) A statement of cash receipts and disbursements;
- (6) A statement of official properties, materials and supplies held in custody for the government;
- (7) A balance-sheet;
- (8) A list of supporting original evidence.

For a state-owned corporation, on the other hand, a settlement account would consist of:

- (1) A statement of receipts from operation;
- (2) A statement of actual expenditures;
- (3) A statement of cash receipts and disbursements;
- (4) A balance-sheet;
- (5) A profit-and-loss statement;
- (6) A statement of inventories.

When the settlement account is submitted to the ministry of audits, if found in compliance with the rules and procedure of the ministry, a certificate of approved audit will be issued. Otherwise, the account will be sent back to the organization for further explanation. It is sometimes found necessary that a special audit be made for doubtful cases.

#### SPECIAL FEATURES OF THE AUDITING SYSTEM IN CHINA

After having outlined the organization of the ministry of audits and the procedure of the auditing system, I shall now mention briefly some of the special features of the auditing system in China.

First, the control "yuen" is one of the highest branches of the five "yuens" in the Chinese system of government administration. The fact that the ministry of audits is directly under the control "yuen" suggests that its work can be carried out independently of the influence of other authorities and that its decisions and findings can be made without any bias.



Secondly, the ministry of audits has the final decision on all settlement accounts submitted by different organizations of the government; whereas, in other countries, this power is reserved to congress or parliament. When an organization, after its settlement account has been audited, is charged with an illegal act, as stipulated by the ministry, the ministry has no power to render any verdict, but it has a right to recommend one.

Thirdly, in important cases, the auditor-general calls a conference of all auditors and inspectors to discuss the cases and render decisions accordingly.

Fourthly, in most countries, pre-audit examinations are of expenditures only. Under the Chinese system both receipts and expenditures are involved.

Fifthly, in the Chinese system, all organizations are required to have a pre-audit examination of their receipts and expenditures, and a post-audit examination of their settlement accounts. Thus an audit takes place before and after the incurring of any liability. Sometimes auditors are appointed to stations in the various government organizations in order to make a closer scrutiny of all accounts and transactions of those organizations whose accounts are found doubtful.

Lastly, some countries base their audits strictly according to rules and regulations regardless of the facts of the case. This, therefore, involves a great deal of red tape and unnecessary inconvenience. But in China the practice is different. Although an audit is based strictly upon the budget, any item not based upon fact or any item of expenditures which is uneconomical shall be returned for further explanation. On the other hand, any item if based upon fact will be perfectly in order, even though it is not provided in budget estimates. Thus, the Chinese system is more flexible and more harmonious with changing conditions.

#### CONCLUSION

As I said at the beginning of this article, auditing is emphasized more in the Chinese constitution than in any other country and it is clear from the above that the ministry of audits plays a considerable part both in the administration of government finance and in the financial reconstruction of China. But there is much room for improvement of the audit system. Since, for instance, the main purpose of auditing is to disclose, and the main idea of a well regulated auditing system is to prevent, fraudulent

practices and to supervise financial administration of public officers, an audit of materials, supplies and other assets held in custody by public officers for the government will, in all probability, serve even a greater purpose than would an audit of cash receipts and cash disbursements. This, sad to say, is exactly the case in government auditing in China.

Another shortcoming of the Chinese system is the fact that too much emphasis has been given to the verification and checking of the accuracy of reports submitted. Such factors as prices of materials, construction costs, loan agreements, interest and uses of government bond issues, contracts on government purchases, etc., have never, in practice, been given enough attention in the course of audit. Until such factors have been recognized in practice, it is hardly justifiable to conclude that the present system of government auditing in China will play a very effective rôle as a check against fraudulent practices of financial officers in government organizations. If an organization, for instance, such as the ministry of audits, which has a history of more than 4,000 years behind it, existed merely to check the accuracy of figures of reports presented; an injustice would be done not only to the government but to Chinese taxpayers as well. Furthermore, an audit department which can not function independently to guard against irregular practices and illegitimate manipulations of accounts by financial officers has no "raison d'être." But in view of the transitional period of economic adjustment and political consolidation one naturally expects to find some flaws in the audit system and inconsistencies in its application; and I firmly believe that the present government is earnestly trying to work out an auditing system which will be as nearly perfect as is humanly possible.