

**YANG'S LAW AND ZHU'S MANDATE:  
The Roles of Accounting in Managing the Chinese State**

**杨氏规律和朱总理指令： 会计的治国角色**

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First Global Forum of Chinese Scholars in Public Management  
Sun Yat-sen University, Guangzhou, China  
May 29, 2010

**Introduction**

I am an accountant by training with a personal interest in public policy analysis. I have been a participant observer of American government budgeting and accounting for almost forty years. After leaving China in 1963, I returned thirty years later to teach and to advise the Chinese government on budgeting and accounting reform.

I have spent the last two weeks giving lectures on government accounting to public finance students at Peking University and the Central University of Finance and Economics. Now I am in the company of distinguished public administration scholars.

Therefore, I couldn't help feeling “受宠若惊” [being flattered to the point of feeling apprehensive]. Perhaps the value of government accounting is appreciated after all. Thank you for giving me “a seat at the table” for your discussion of fiscal policy and management.

**Economic Development and Accounting/Auditing Development**

The late Professor Yang Shizhan (杨时展教授) of Zhongnan University of Law and Economics asserted, “天下未乱计先乱，天下欲治计先治。” [“Social chaos is preceded by disorderly accounting and auditing. Putting accounting and auditing in order is a prerequisite for successfully ruling the state.” Actually, 天下 could mean anything under the heavens!] By 计, Professor Yang was referring to both accounting (会计) and auditing (审计). These statements appeared in his essay written in the early 1990s to urge the establishment of a government accountability system in China. Professor Yang saw a positive relationship between accounting and auditing as accountability institutions and economic development, as he further claimed, “未有经济发达的国家而二计不发达的;亦未有二计不发达的国家而经济能发达的。” [There have never been economically advanced countries without highly developed accounting and auditing systems; nor are there countries which have achieved economic prosperity with poorly developed accounting and auditing systems.]

Evidently, Professor Yang's view about the importance of accounting and auditing was shared by former Premier Zhu Rongji (朱镕基). Of all the Chinese leaders, the former premier probably had the greatest appreciation of the importance of accounting. In one bold stroke, he

directed the creation of three National Accounting Institutes (NAI). These training centers are located in Beijing, Shanghai, and Xiamen. His exhortation for accountants and auditors to “坚持准则, 不做假帐” [“I urge you to uphold standards and refrain from rendering false accounts.”] is inscribed on a huge rock at the entrance of the Beijing NAI. These words have inspired me over the years to think about appropriate government accounting standards and to inquire what comprises “false accounting.” I think the premier would be quite proud of the fact that Chinese business accounting standards have developed to the point of being in harmony with international standards.

## Government Accounting in America and China

Unfortunately, there has been far less progress in the area of government accounting. There are many reasons for this. Fundamentally, it comes down to the fact that while there is a business side to governments, governments are political institutions. Government accounting is therefore a language of politics. Being situated in the intersection of power and money, the development of government accounting, or lack thereof, basically has more to do with political will than with technical competence.

In this regard, I am struck by the paradoxical performance of the American government and the Chinese government in fiscal policy and fiscal management (which includes accounting). In my view, the U.S. government deserves a failing grade or a marginally passing grade for its fiscal policy. In contrast, the U.S. government has done much better in fiscal management. How is this possible? The reason is that while managers operate within financial parameters (i.e. revenue, expenditure, deficit, and debt) set by policy makers, the abundance of technocratic talents in America has not prevented the larger political, economic and social forces from producing an unsustainable fiscal policy.

On the other hand, despite its remarkable successful fiscal policy, Chinese public financial management has a mixed record. The Chinese government merits a good grade for having instituted a system of departmental budgeting throughout government, but this is offset by a very poor grade for its inability to eradicate systematic, large-scale financial corruption.

I would give the United States a fairly good grade in government accounting. Most American governments now routinely prepare and publish annual financial reports in addition to their budgets. Furthermore, accrual accounting standards are in place to require governments to report their cumulative assets and liabilities, in addition to one-year revenues and expenditures.

In both China and the United States, government accounting is a part of the management and accountability cycle; accounting follows budgeting and precedes budgeting. However, government accounting in the United States is comparably more powerful than its counterpart in China. In the United States, government accounting dutifully fulfills its role in enforcing budget execution and reports actual financial performance in relation to the budget. In addition, however, the accounting office is largely independent of the powerful budget office. By following generally accepted accounting principles (GAAP), government accountants quantify and disclose,

in addition to calculating obvious bonds payable, long-term liabilities, such as huge unfunded pension and other retirement benefits created by current policies and decisions.

Furthermore, thanks to the accounting standards, the U.S. government can and does report its annual deficits on both the accrual basis and cash basis. In fiscal year 2008, the accrual deficit number was more than twice as large as the cash deficit number. The main reason was that pension and other benefits earned by military and civilian employees—amounting to a \$550 billion increase in government liabilities—were treated as expenses. On the other hand, the huge amount of cash borrowed to rescue failing banks and businesses and to stimulate the economy during the recent financial crisis resulted in a cash deficit larger than the accrual deficit in fiscal year 2009. These annual deficit numbers have contributed to creating much larger cumulative public debt and liabilities—and financial responsibilities—under social insurance programs. Together they have given rise to considerable soul searching about whether a government in a democracy and volatile market economy is doomed to permanent deficits.

Despite these problems—and there are many problems—the government at all levels in the United States acts on the principle of fiscal transparency and lays bare its flaws. Without this willingness to disclose unpleasant facts, I could not have presented these numbers for you to see, and perhaps criticize, the fiscal performance of American governments.

The current stage of development of American government accounting is the result of progress made over the past one hundred years of fighting corruption, practicing professional management, and promoting public accountability through disclosure. After succeeding in producing voluminous budgets and financial reports, we now face the dilemma of having access to so much data that the challenge is not simply to make fiscal information available, but also to make it accessible and coherent to the American people.

### **Challenges Facing Government Accounting in China**

If the challenges to government accounting in America are great, those facing Chinese government accounting are even greater. I readily acknowledge improvements in Chinese public financial management. Since we are here to solve problems, please permit me to focus on areas that require corrective actions. To my knowledge, except for the Hong Kong Special Administrative Region, no Chinese governments at any level have published a statement of its assets and liabilities. Every year the National Audit Administration creates an “audit storm” to great public acclaim. Names of corrupt officials and guilty units are identified and the amounts of stolen, misappropriated, or wasted money are reported. However, these audit success stories reflect the failure of accounting and internal control to have prevented the malfeasance in the first place. Unless financial mismanagement is corrected and the problem of pervasive manipulation of raw data is solved, it is difficult for governments to produce credible financial reports. Accounting systems are subject to the “GIGO” law of “garbage in, garbage out.”

The preparation of detailed department budgets is a major achievement. I was hoping that departmental budgets would lead to other steps to remedy the weaknesses of the current

“budget accounting” system. Good department or unit accounting is necessary to produce data for aggregation to the whole government. Unfortunately, standards for accounting by the finance departments (财政总预算会计), administrative units (行政单位会计), and public service units (事业单位会计) have remained essentially the same for decades. I am glad that some new standards for hospitals and universities have been proposed. Much more remains to be done in accounting at the government level. In addition to conceptual and practical difficulties, the reluctance to formally and officially recognize liabilities and cost of government services is a major hurdle to overcome.

For example, despite the open secret that local governments do find ways to incur deficits and borrow money—despite the legal inhibition to the contrary—these local governments are not required to prepare statements of assets and liabilities. If those statements are prepared, they would face the possibility of regarding their fund-raising instrumentalities (e.g. credit and investment companies) as a part of government. I personally do not believe it is necessary to wait for the passage of a revised budget law to do good accounting.

In summary, the basic role of accounting in managing the Chinese state is to enforce finance-related laws and regulations, including the budget. An intermediate role is for accounting to facilitate systematic and efficient financial management. An advanced role is for the government to prepare and audit financial reports to discharge its accountability to the people.

I hope that Chinese government accountants, similar to their counterparts in the United States, will develop their technical competence to the point that they can direct managers’ attention to problem areas and even serve as consultants to help solve financial problems.

I urge you as government policy makers and managers to let government accountants out of the back office and sit at the table with you as you make fiscal policy and manage the government’s fiscal affairs.

Thank you.