Government auditing in China: Problems and reform

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This paper evaluates the current government auditing system in China and the proposal to move it from the control of the executive body (the State Council) to the control of the legislature (the National People's Congress). Interviews with government auditors, government and people's congress officials, and leading academics identify the problems caused by lack of audit independence. Although audit independence can be increased by moving the control of government auditing to the legislature, many of our interviewees considered such a move as infeasible in the current political climate. To smooth the reform toward a legislature-led audit system, we propose a "Dual-Track System" in which the different audit responsibilities currently undertaken by the government auditing system are separated. The responsibility for auditing the use and control of fiscal budgets by the central and regional governments would be under the control of the legislature as this area of government auditing has a clear need for audit independence. Other audit functions including economic responsibility auditing, special purpose funds auditing, financial service auditing and state-owned enterprise auditing would remain under the control of the government. This dual track approach would, we argue, be a politically acceptable compromise as it would strengthen audit independence where it is most needed but also enable the government to maintain strong economic control.

1. Introduction

For 30 years after its foundation in 1949, the People's Republic of China went through a series of major mass political movements which left it extremely isolated from the rest of the world, especially capitalist countries. At the brink of a total economic collapse, China shifted its focus to economic development, began market-oriented economic reforms, and adopted an open-door policy in 1978. These changes revived both government auditing and independent auditing (or social auditing in Chinese terms), which had been replaced by other monitoring mechanisms in the 1950s (Hao, 1999; Xiao, Zhang, & Xie, 2000).

Fig. 1 shows that the political structure in China consists of three organisational systems: the National People's Congress (NPC) as the supreme legislature, the State Council as the central executive body or central government, and the People's Supreme Procuratorate and Court as the legal enforcer. While the State Council and the People's Supreme Procuratorate and Court are responsible to the NPC and its Standing Committee, all of these central organisations are under the leadership of the Central Committee of the Communist Party of China (CPC). These systems also have their regional presence at the levels of province, municipality, and county. Thus, for example, there are the governments, people's congresses, and people's procuratorates and courts of provinces, municipalities, and counties. These regional bodies are under double leadership — the offices at a higher level and the CPC committee at the same level in the hierarchy.

As required by the 1982 Constitution of the People's Republic of China (PRC, 1982), the National Audit Office (NAO) was set up in 1983 as a department of the State Council. In addition, regional audit offices were also set up as departments of provincial, municipal and county governments. A regional government audit office is under the leadership of both the government audit office at a higher level and its supervising regional government. For example, the audit office of a provincial government is subject to the joint leadership of the NAO and the provincial government. Under the dual leadership system, for a provincial government audit office, the NAO provides auditing and regulatory guidance and monitoring while the provincial government offices...
disclosure and the problems exposed attracted much media attention for the first time disclosed to the public that serious illegal acts in certain large cities, one as a branch of the central government, and their associated institutions. These branch audit offices located in ministries and very large municipalities are under the direct leadership of the NAO.\(^6\)

Although this government audit system has made significant contributions toward China's economic reform and opening up to the world in the past 20 years (Chinese Auditing System Research Group, 1999), it also suffers from the lack of audit independence. The existing problems of government auditing mainly stem from it being under the direct control of the executive body (the State Council). Under this system, various government departments and officials can, both theoretically and practically, interfere with government auditing, thus weakening the objectivity and fairness of the audit. However, the people’s congresses at various levels have begun to attach significant importance to, and make increasing use of, the audit report. At the same time, more and more taxpayers have begun to pay attention to how their money is used by the government. While the NAO’s lack of independence has always been a problem even since its establishment, this problem is creating increasing tensions in the current political setting because of the accountability needs of the legislature and taxpayers. The accountability relationship between the government and the legislature is compromised by the fact that the auditor is not independent of the government.

Notwithstanding these problems, the NAO has stepped up the level of public disclosure of audit findings in recent years. In 2003, the NAO for the first time disclosed to the public that serious financial problems existed in four ministries of the central government. This disclosure and the problems exposed attracted much media attention and the phrase “Audit Storm” was used to refer to the disclosure and the issues raised. This “Audit Storm” continued in 2004 and 2005 when the NAO in its annual report disclosed the serious illegal acts in other ministries of the central government. However, although this storm has been useful in drawing attention to some of the problems that had occurred, the level of audit independence means that only a small percentage of the total were exposed. Also, even where problems are exposed, this does not ensure that the same problems will not recur. Thus, the “Audit Storm” has heightened the awareness of the need for government auditing reform.

In recent years, Chinese scholars have been exploring ways to improve government auditing. Whilst the NAO itself is concentrating on improvements in the existing system, studies outside the NAO tend to focus on the need for a more significant structural reform (Chinese Auditing System Research Group, 1999). Audit independence is generally recognized as a key requirement of attempts to reform the current government auditing system (e.g., Yan, 1986; Yang, 1989; Qin, 1994; Zhang, 1996; Xiang, 2002).\(^7\) This has led researchers to put forward various proposals such as the “Legislature Approach”, “Line Management Approach”, and “Upgrading Approach” (to be explained in the next section). Among these, the “Legislature Approach” is more widely accepted and discussed in the academic community. This approach proposes that in order to ensure audit independence, the NAO should break away from the State Council (the central executive body or central government) and become a part of the NPC (the parliament of China). Similarly, regional government audit offices would also be transferred from regional governments to regional people’s congresses. This change would bring China’s government auditing structure closer to that in the United States and the United Kingdom.

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\(^6\) Thus there are two government audit offices in certain large cities, one as a department of the municipal government and the other as a branch office of the NAO. The former is subject to dual leadership whereas the latter is under the leadership of the NAO only.

\(^7\) Jones and Pendlebury (2000, 243), however, point out that in the context of government auditing, complete independence of the auditor from the government is not possible. They state that it is difficult to maintain audit independence in any context but perhaps it is most difficult at the level of sovereign governments. It is likely that most supreme auditors around the world would be hard-pressed to claim much independence from their governments.
government auditing from the perspective of public accountability. However, as the “Legislature Approach” relates to structural reform of the State Council and requires substantial constitutional amendments, it might be difficult to obtain political support.

We therefore argue in this paper that any reform proposal needs to consider not just audit independence issues, but also the possibility and practicality of the reform itself. In China, the possibility of government auditing reform is closely related to the power relationship between the State Council and the NPC. This relationship makes it difficult, if not impossible, to adopt the “Legislature Approach” at present. We argue that any proposal for government auditing reform should be evaluated against two criteria: an ability to satisfy the political sentiments of the above power relationship and an ability to improve state audit independence. For this reason, we propose a “Dual-Track System” as an interim step towards a future legislature-led system. This proposal recommends that the legislature and the government will set up separate audit organisations to perform different audit functions. Specifically, we propose that the audit task of proper assurance over the implementation and control of the fiscal budget (budget auditing) should be transferred from the current government audit system to the legislature, while other audit functions remain under the control of the government.

This study is based on interviews carried out during June to October 2002 with 34 officials from the NAO and its local audit offices, people’s congress officials, and leading audit scholars. This paper also uses speeches made by government, state auditing, and people’s congress officials, published studies by other scholars, and related information posted on the NAO Web site. The study seeks to examine the problems of government auditing, review existing reform proposals, and present a new proposal for reforming the current government audit system. Such a study is important because it increases the awareness of foreign researchers and investors of the unique problems and dynamic issues facing government audit in a transition economy such as China. In particular, it sheds light on the process through which people’s democracy evolves (e.g., the quest for increasing powers by the NPC) and the interaction between the development of democratic politics and government auditing. In addition, while academics and politicians in China have criticised current government auditing for its lack of independence, none of these criticisms is based on systematic evidence. Our study substantiates these criticisms with empirical data obtained from a series of interviews and provides additional insights into issues surrounding the independence of government auditing. Most importantly, however, such a study may influence and contribute toward China’s on-going political and economic reform (especially government audit reform).

2. Literature review

Research on government auditing in China began when the NAO was first established in 1982. Yan (1986) and Yang (1989) investigate government auditing from the perspective of public accountability. They point out that the government audit system – functioning to evaluate and report on the government’s accountability to the people and to the legislature – should have been set up independent of the government. Qin (1994), Zhang (1996), and Xiang (2002) extend this research on the relationship between public accountability and government auditing and propose the “Legislature Approach”. Wen (1990, 60), adopting the perspective of how democratic politics affects government auditing, argues that the wider the democratic scope and the larger the power of democracy, the more restraints people can exercise upon the government through government auditing. Therefore, according to him, the development of democratic politics may well affect the development of government auditing and the NPC will eventually “own” the NAO.

In comparison with Western auditing systems, Xiao, Zhang, and Liu (2000, 353) consider China’s government auditing to be less independent. However, they take a dialectic view that in spite of its limited independence, the current government auditing system is most appropriate to satisfy the situation in China because, it is more suited to the requirements of a country with a highly centralised executive authority. By contrast, Yin (2001) puts forward the “Upgrading Approach”, under which the NAO should be placed under the control of the State Council, but the auditor-general of the NAO should be promoted to a rank equivalent to a Vice-Premier or a State Councillor. A similar arrangement would also be made for auditor-generals at regional government level. This would, the author suggests, increase the enforcement power and independence of government auditing. Moreover, Li, Xu, and Liu (2001) and Wu (2002) advocate a “Line Management Approach”, whereby the current joint leadership role of regional governments in regional government auditing should be removed in order to establish a vertical and unified leadership. That is, under this system, the higher level government audit office alone provides leadership to lower level government audit offices. This would avoid regional governments’ interference with government auditing.

Although these proposals differ, they are all based on the assumption that audit independence is the essential requirement of effective government auditing. However, both the “Upgrading Approach” and the “Line Management Approach” fail to make radical changes to the structure in which the government directly controls government auditing. Therefore, although the implementation of these approaches might bring about some improvements, it would not lead to the true independence of the auditor from the executive and thus would not meet fully the accountability needs of the legislature. As a result, these views lack widespread political support and it is the “Legislature Approach” that continues to dominate the current debates and discussions (e.g., Qin, 1994; Gao & Shi, 2003). Many commentators consider the “Legislature Approach” not only as a representative view, but also a synonym for government auditing reform (e.g., Zhang, 1996; Xiang, 2002).

While there appears to exist a rather unified academic view that government auditing in China currently lacks independence, the official research organisations show a more supportive attitude (for instance, the Chinese Auditing System Research Group at the Institute for Auditing Research of the NAO (1999)). Although they admit that government auditing is essentially an internal department of the State Council, they do not consider the lack of independence to be a major problem of current government auditing.

3. Methodology and data

It is necessary to understand the existing strengths and weaknesses in the current government auditing system before we can improve or reform it. Ideally, this would be undertaken by measuring its effectiveness and the extent to which it has achieved the expected outcomes. In reality, the absence of an evaluation system and reliable, complete and objective data means that the effectiveness of the current systems can never be properly measured. An alternative

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8 In the UK, the Comptroller and Auditor General’s (C&AG) independence is achieved, at least in theory, by taking the appointment of the C&AG out of the control of the executive and making the statutory responsibility of the C&AG that of reporting to the House of Commons (Jones and Pendlebury, 2000, 233). This independence was strengthened by the 1983 National Audit Act that significantly reduced the influence of the Treasury (part of the executive) over the work of the C&AG.

9 This is not a problem that is unique to China. The effectiveness of government auditing is always difficult to measure in an objective manner. The number of frauds detected, the instances of waste and mismanagement identified, the number of studies into efficiency and cost control etc are pertinent indicators, but the true impact of government audit on the proper control and deployment of public spending can never be reliably and objectively determined.
The choice of an interviewee was mainly leading audit scholars (see Panel A of Table 1). The interviewees were leading academics, government auditors, government officials because this research focuses on the government auditing system and because its reform is related to a profound understanding of government auditing and its problems. We therefore undertook face-to-face interviews with 34 government audit officials, people’s congress officials, government officials, or their deputies) in order to obtain a more balanced view. Moreover, these interviewees occupied leadership positions in their organizations. They therefore had had worked in auditing or related fields for more than 10 years and, under the leadership of the Premier, also manages auditing affairs nationwide. Moreover, a regional government at and above the county level should set up a regional government audit office, under the leadership of its government and the auditing authority at a higher level of hierarchy. Finally, regional governments should take responsibility for resourcing government auditing organisations.

We can see from the above that the NAO is a functional department of the central government (the State Council), specialising in auditing. Similarly, regional government audit offices are internal departments of regional governments at various levels. Under the leadership of the chief government officers (CGO), such as the governor of a province or the mayor of a city, regional governments at various levels schedule the work for audit offices, nominate auditor-generals, and allocate auditing resources. They are also the direct user and beneficiary of audit reports. Obviously the audit offices are a link in the government’s administrative hierarchy. “Internal auditing” is therefore a basic feature of government auditing in China.

In practice, a typical government audit office performs five main categories of audit. First is budget auditing which started in 1996 as required by the Budget Law (PRC, 1994b) and the Audit Law (PRC, 1994a). The purpose of budget auditing is to provide assurance on the legality of fiscal budget implementation, the reliability of its outcomes, and the effectiveness of budgetary control at all levels of government. The government audit office is required to report the budget audit results to the government body of which it is a part and, if necessary, to a higher level government audit office. For example, the provincial government audit office would report its findings to the provincial government and the NAO. After being examined and approved by the government, the government audit office must also report the findings of the budget audit to the standing committee of the people’s congress (in the example of a provincial government, the provincial people’s congress). The standing committee of the people’s congress will then review these findings. We asked our interviewees for their estimates of the proportions of the audit workload taken up by budget auditing. From their responses, budget audit accounts for approximately 30–40% of the workload of the NAO, over 50% of the workload of provincial audit offices and below 30% of the workload of county government audit offices.

The second main category of government audit is economic responsibility auditing. This is required by the Regulation on Auditing the Economic Responsibilities of Party and Government Officials at or above the County Level and the Regulation on Auditing the Economic Responsibilities of State-Controlled-Enterprise Managers. Both of these regulations were approved and issued by the Central Committee of the Communist Party and the State Council in 1999. In this type of audit, the auditees are Communist Party officials, government officials, or managers

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10 Three did not wish to participate and the other three were not available.

11 Before 1996, government audit offices only audited application of budgeted funds by government units at a lower level of a government, rather than the implementation of the budget for this government itself.
of state-owned enterprises. The focus of the audit is on whether these individual officials or managers are earnest and effective in performing their official duties while in office. The audit report is mainly used by disciplinary and organisational departments of the Communist Party and government. According to our interviewees, while the NAO currently carries out little economic responsibility audit, this type of audit accounts for about 50% of the workload of government audit offices at the municipal and county levels. This is also an important task for provincial government audit offices.

The third type of government audit is the audit of special purpose funds, including poverty relief funds, government bonds, social welfare funds, railway construction funds, and basic education funds. The fourth type of government audit is financial services auditing, including the audit of banks, insurance companies, and international loans. The final main type of government audit is the audit of state-owned or -controlled enterprises. The legal source of these last three types of audit is the Audit Law (PRC, 1994a) and the government is the user of these audits. These are the traditional functions of government auditing and had been especially important before budget audit and economic responsibility audit were initiated.

4.2. Perceived merits of the current government auditing system

The current government audit system is perceived as having several apparent advantages by government audit officials (see, for example, Chinese Auditing System Research Group, 1999) and some of our interviewees. First, the fact that the chief government official (CGO) takes charge of government auditing can signal strong support for government auditing and is therefore beneficial to a fuller realisation of the audit function. Second, as the government controls human, financial and material resources, it is easy to resource government auditing. Third, auditing work becomes more convenient, more efficient and more focused when centered around government operations. Finally, the problems identified in government auditing can be dealt with more quickly and efficiently.

It can be argued that these merits of the current government auditing system in China stem from a direct combination of government auditing and governmental economic control under the State Council and regional governments. The advantages may be seen from the fact that the government-led audit office in China has undergone rapid development since its establishment in 1983. As a result, China has formed a quite complex government audit organisation and has developed a set of auditing regulations and standards centered on the Auditing Law (1994). Teams of auditors have been trained and now have the skills and experience to conduct high quality audits. By 1998, there were over 3000 government audit organisations with 80,000 auditors (Chinese Auditing System Research Group, 1999). In addition, government auditing is seen to have produced a marked effect. At a national auditing theory forum held in August 2003, Auditor-General Jinhua Li (2003) concluded that since the foundation of the NAO more than three million institutions had been audited, 130 billion RMB misspent expenses and misappropriated funds had been reclaimed, and more than 140 billion RMB fiscal revenues had been recovered as a result of the audit. High level government audit officials often praised government auditing for its rapid development and achievements and cited this as evidence of the superiority of the current government auditing system. For example, Auditor-General Li, in a public presentation made in September 2003, explicitly pointed out that the current government auditing system is suited to China’s actual circumstances, and that the achievements of the NAO during the past 20 years had been made possible by this system (Wu, 2003).

However, this government auditing system also has many problems as detailed in the next section. Although government officials do mention certain practical problems of government auditing, such as quality issues and resource issues, they largely neglect its more systematic problems of lack of audit independence. Furthermore, by drawing attention to the success of the current system, they divert attention away from the need for reform. Our interview results provide an alternative to the above official assessment of the current government auditing system and these reveal some interesting differences.

4.3. Perceived problems of the current government auditing system

Most interviewees believed that the current problems of government auditing have their origins in its relation to the government, i.e., the NAO is in effect an internal auditing department under the government’s direct control. The following paragraphs elaborate the main problems identified in the interviews.

4.3.1. Lack of audit independence

The majority of our interviewees acknowledged some direct or indirect intervention by people or organisations from outside the NAO. These have a strong negative impact on audit planning, the training and appointment of auditing personnel, the determination of audit tasks, the dealing with problems identified in the audit, and the disclosure of audit results. As a result, the NAO can hardly perform any independent auditing.

A director-general of a provincial government audit office commented:

The problems identified in the audit should be dealt with in accordance with law, but if the problems involve the government, the audit office will experience interference from the governmental officials in charge or from other authorities.

Some interviewees acknowledged the lack of independence of government auditing, but at the same time they did not want to exaggerate the problem. Being a department directed by the government, how can the audit office work independently free from the interference of the government or the chief government officials (CGO)? Is the result of interference inevitably detrimental? The interviewees found it hard to answer these questions. Besides, the audit office and the government are at different administrative levels and may not always have consistent perceptions on auditing. Under this circumstance, as was revealed in the interviews, the audit office, being at the lower level, would normally follow the government’s will — and this is understandable.

We argue that if auditing is supposed to satisfy merely the needs of the government, or if government audit is supposed to play a supporting role to governmental work, then the problem of limited audit independence is relatively partial, because government auditing still achieves its main objective. But if the people’s congress and taxpayers outside the government are also audit clients, and entrust the government audit office to investigate how the government implemented fiscal budgets approved by the people’s congress, then the control relationship between the audit office and the government becomes a severe problem. An immediate consequence of the lack of audit independence is that the audit report may no longer possess objectivity and fairness and it is therefore less likely to gain the trust and acceptance by the people’s congress and the public.

4.3.2. Restricted disclosure of audit results

The interviewees generally felt that the disclosure of audit results might be restricted. A deputy CGO (a deputy mayor) of a municipal government commented in the interview:

The audit report follows governmental arrangements, but this does not necessarily indicate that the government will prevent the disclosure of audit issues. Whoever acts as the CGO faces external

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12 RMB stands for renminbi, i.e., people’s currency, in China. The current exchange rate is about $1 = 6.9 RMB yuan.
pressure and thus s/he will disclose something, explain it to the
delay of the audit office. But will the CGO disclose all the issues or important issues then? Will
the issues concerning his/her annual report be disclosed as they
really are? One can never tell.

A director-general from the NAO admitted:
In fact, some government officials interfere with the audit office in
reporting audit results to the People’s Congress. They even directly
advise the audit office to remove big issues that violate
regulations from the audit report.

An official from the NAO also admitted in the interview that some
local governments and related authorities interfere with the dis-
closure of audit findings and the resolution of audit results in order to
shirk responsibilities and avoid excessive disclosure that might
overshadow their political career. The interview data thus suggests that
the audit office is not only constrained by the government in
terms of audit planning and the determination of audit tasks, but also
the disclosure of audit results. That is, the audit office cannot make its
own decisions on what to disclose, how to disclose, and when to
disclose. Consequently, there is no assurance on the authority and
transparency of audit reports. With the submission of audit reports to
the people’s congress, this problem of a lack of independence and
transparency has aroused increased concerns. Since the Constitution
(PRC, 1982) and the Audit Law (PRC, 1994a) lack clear and rigid rules
on the disclosure of audit results, the content and degree of disclosure
in the current auditing system are determined and censored by the
government’s discretionary disclosure policies on government affairs
and are also heavily affected by the attitudes of CGOs.

4.3.3. Auditing gaps
Most interviewees mentioned the same problem: the audit is only
applied to government units at a lower level of the hierarchy. That is,
the audit rarely examines the responsibility and performance of the
government itself or its CGO, and hence the depth, level, and scope of
auditing are rather restricted. The following comment made by an
interviewee who is a director-general at the NAO is representative of
the views.

From a legal point of view, there will not be any constraint on the
audit of decisions made by higher-level officials, but in practice
you cannot really question them. If in the audit process we
discover problems or mistaken decisions made by high-level
officials, we would rather not disclose them. We would assume
that the government always does the right thing. That is to say, if
the problems arose from decisions made by the government, we
will not bother about them any more. How can we supervise our
superiors? We are only a department of the government.

Some of our interviewees also mentioned that in budget auditing,
since the audit does not actually involve the financial responsibil-
ity and performance of the government and its CGO, it is unavoidable that
many big issues are overlooked or neglected, especially those related
to the government or CGOs themselves. Given that many problems
result from governmental activity, the audit office can do nothing and
the problems can appear over and over again. This kind of auditing
exhibits a serious problem of power centralisation.

4.3.4. Budget audit as a mere formality
Some interviewees questioned whether audit results would be
reported accurately to the people’s congress even if the audit office
carried out budget auditing at the government level. If the govern-
ment determines the content of the audit report, budget auditing is
in effect the government’s “self-inspection”. The Constitution (PRC,
1982) empowers the CGO with respect to both auditing and financial
matters. However, in many local governments, the CGO holds the
financial decision-making powers while the deputy CGO is delegated
to take charge of auditing. This situation might make it more difficult
for the audit office to monitor fiscal and financial activities of
the government and its CGO simply because the deputy’s unwillingness
to expose a CGO. This is reflected in the remarks made by one
interviewee, a deputy director-general at a provincial government
audit office:

The difficulty that the audit office faces in performing budget
auditing is truly enormous, because fiscal and financial powers
rest in the hands of the CGO. Important fiscal and financial issues
and the annual fiscal and financial budget must be decided by the
CGO. Once the budget is set, any budget adjustment must also be
approved by the government and its CGO. Under such conditions,
auditing fiscal and financial budgets would be equivalent to the
audit of the government and it’s CGO. Thus, auditors face not only
the finance department but also the CGO. In the auditing process,
if the finance department tells the auditor that the CGO does not
give permission for something to be audited, then the auditor will
not have the necessary access.

Moreover, as the relationship between the people’s congress and
the government is that of supervisor and supervisee, it is difficult, if
not impossible, for the government audit office to serve two
“masters”. In such a conflicting situation, the government audit office
may only put the government’s interests and requirements first, since
the government is its direct “boss”. To serve the government in
essence and the people’s congress in appearance is an inevitable
choice of the government audit office under the current system.

The legislature therefore cannot directly exercise audit supervision
and can only indirectly monitor the fiscal budget through auditing.
The legislature also lacks other practical approaches and tools for
monitoring the implementation of fiscal budgets and this limits its
ability to obtain an insight into the workings of financial systems and
budget implementation. The legislature can therefore play a very
limited role in monitoring financial systems and fiscal budgets.

5. The “Audit Storm”
In 1999, the NAO provided an Audit Report to the Standing Committee
of the National People’s Congress. In this report, it criticised several
central government ministries for breaching regulations. In 2001, the
NAO issued a Standard on The Disclosure of Auditing Results which
stipulates that government audit offices may disclose the audit results to
the public if it is requested by the same-level government or the upper
level government audit office. The standard also identifies three
conditions for disclosing audit findings: the disclosure must not harm
national security, must not harm the auditee’s commercial secrecy, and
must take into account social consequences. In 2002, the NAO stipulated a
regulation on audit disclosure in the form of public statements. On 25
June 2003, the NAO for the first time published an audit report to the
public in which it revealed the problems that it identified in its audits.
Most importantly, it specifically pointed out the wrongdoing committed
by four central government ministries. In 2004 and 2005, the NAO
published a series of Statements of Auditing Results, exposing, among
others, severe illegal activities (involving theft) and wasteful expenditure
that took place in more than 30 central government departments or other
national state owned organisations.

The NAO’s 1999 report attracted a strong reaction from the
Standing Committee of the NPC which accordingly decided to
strengthen its monitoring over state budget implementation. But
this reaction had limited impact because the audit report was not
publicly disclosed. However, the publication of the audit report by the
NAO in 2003 caused a national stir and was reported by all major
media. The term “Audit Storm” has since been used to describe the
In recent years, the problems and the need for reform of current government auditing have attracted the increasing attention of the people's congress. Some standing committee members of the NPC have frequently questioned the audit report submitted by the NAO by raising issues concerning central budget implementation and other fiscal revenues and expenditures. A research group of the NPC standing committee has also investigated the problems of the government auditing system. At the 2003 NPC plenum, 30 congressmen/women submitted a joint proposal recommending that the state audit office be set up within the people's congress (Wang, 2003).

We suggest that as more and more political forces become involved, the necessity of adopting this reform approach will undoubtedly increase. The experience from other countries suggests that government auditing, as part of a political structure, rarely develops on its own. Rather, its development is closely related to the development of democratic politics and the perfection of political structures. During this process, the impetus provided by the legislature plays a key and positive role. Therefore, we believe that the people's congress in China will play an increasingly important role in shaping the government auditing system and will strengthen its links to the NAO. However, this does not necessarily mean that it is easy or feasible to move the NAO completely from the government to the people's congress immediately. This difficulty is well reflected in the negative or 'unsure' views about the legislature-oriented approach held by 35% of our interviewees.

One reason revealed from the interviews for so many of our respondents holding these views relates to an important characteristic of the government structure in China—the highly centralised political power. In the early 1980s when China established its government auditing system, the primary motive was to maintain and strengthen the centralised function of the government's economic control. At that time, both national administrative powers and economic control powers were concentrated in the hands of the central government. By contrast, the people's congress has only recently begun to develop its power base. Furthermore, the economic reform being pursued by China inevitably led to a number of problems which had to be responded to and monitored and the NAO had an important role in this and also in supporting the government's need to achieve economic control. Also government auditing could only have developed so quickly in China because of the needs and the power of the government, which also provided the necessary resources.

However, over the last 20 years since the establishment of the government audit system, the people's congress system has strengthened its powers, and the governmental monopoly of public affairs has changed significantly. In addition, the people's congress has also paid increasing attention to monitoring the government, especially through budget control. Despite these changes, the centralised nature of the administrative regime has remained, making it difficult for the government audit office to break away from the government. Moreover, as the government still carries the heavy burden of economic monitoring and leading the ongoing economic reforms, it needs a strong audit organ to help it maintain and improve economic order. Finally, the current people's congress system is far from perfect. In particular, as the interaction between the legislature and the government audit system has only existed for seven or eight years, the legislature needs time to increase its familiarity with auditing.

This raises the need to consider the practicality of reform. Moving the government audit office to the people's congress system will almost certainly experience governmental obstruction. Therefore, a good reform proposal should take into consideration the characteristics of the power relations between the government and the legislature. Otherwise, it is likely to lack practicality and become meaningless. It is from this perspective that the "Legislature Approach" may be considered to be infeasible in the current political climate. Furthermore, this approach would require a major revision to the relevant articles of the 1982 Constitution the People's Republic of China (PRC, 1982), which is the legal foundation of the current government auditing system. It is important to note that although the Constitution has been amended three times (PRC,
have added auditors in its budgeting committee. Monitoring budget implementation. For example, the people's congress of Guangdong service auditing and state-owned enterprise auditing. fulfillment what is essentially an internal audit role, with responsibility for economic responsibility auditing, special purpose fund auditing, financial service auditing and state-owned enterprise auditing. The "Dual-Track System" has several advantages. First, it will strengthen the power of the legislature and help develop democratic politics in China. This proposed approach is consistent with the aim of the Constitution to empower the NPC as the supreme legal authority in China (PRC, 1982). In particular, it will ensure that budget auditing will be independent of the executive but leave other audit responsibilities under the control of the government, thus minimizing the shock to the current centralized government structure and economic control. As a result, the obstruction to, and difficulties of, reform will be reduced and as this approach does not require moving the whole current government audit system to the people's congress system, the cost would be smaller. Furthermore, this approach requires a relatively smaller constitutional change compared with the change needed for adopting the "Legislature Approach" and is, therefore, more likely to win support. Finally, the information asymmetry problem would be less severe in the "Dual-Track System" than under the "Legislature Approach". A major issue that would require further study relates to the need for coordination between the two different government audit organizations under the "Dual-Track System". The two government audit organizations would need to coordinate their activities to deal effectively with the inevitable overlaps that would arise between budget auditing and other forms of government auditing.

8. Conclusion

We carried out interviews in 2002 in order to comprehend and evaluate the current government auditing system in China and identify a rational and feasible approach to reforming the system. We also examined the impact of the recent "Audit Storm" on the government auditing system. The results of our investigation show that the current government auditing system in China lacks independence and transparency. The lack of independence affects the objectivity and reliability of auditing which is particularly important when auditing the implementation, use and control of budgeted funds by central and regional governments. It is this aspect of government auditing that has the greatest need for audit independence.

Our analysis of the "Audit Storm" shows that it has increased auditing transparency and attracted much attention from the public, the NPC officials, academics, and government officials to the serious problems in managing public finance. It has also shown that government auditing has an important role to play in protecting public interests. However, merely drawing attention to the problems cannot prevent them from recurring. Also, government censorship means that many problems are not disclosed and it has proved difficult to extend the "Audit Storm" to local audit bureaus. All these weaknesses are rooted in the lack of independence in the current government auditing system.

The "Legislature Approach" has been widely discussed among Chinese academics. Although it emphasises audit independence, it neglects the centralised nature of the government structure, the political tension between the government and the legislature, and the problems that the legislature itself faces. Therefore, implementing this approach in the current political climate may weaken the government's economic control and require a major restructuring of the government and the legislature, thus lacking practicality and feasibility.

To smooth this proposed transition, we put forward a "Dual-Track System" as an interim step toward a fully-fledged legislature-led state audit system. Our proposal suggests that the legislature and the government should set up separate audit organisations to exercise different audit responsibilities. The "Dual-Track System" takes into account both the need to improve audit independence and the feasibility of reform. This approach satisfies the increasing will of the Chinese legislature to strengthen budget auditing while at the same time meeting the need of the government to maintain strong economic control.

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Appendix A. Interview topics

1. How would you describe the audit environment in 1982 when China established its government auditing system?
2. What types of audits does the audit office do? How are the audit objectives and audit tasks determined?
3. What are the advantages of the current government auditing system?
4. What are the problems in current audit work? Among these problems which ones are most closely related to government auditing systems?
5. Is it necessary to reform the current government auditing system? Which approach should be adopted?
6. Being a department directed by the government, how can the audit office work independently free from the interference of the government or the chief government officers (CGO)? Is the result of interference inevitably detrimental?
7. What problems in Topic 4 can be solved by the reform of the government auditing system?
8. Do you agree that the current government auditing system should be placed under the control of the people's congress?

14 Some local people's congresses have already set up their own auditing teams for monitoring budget implementation. For example, the people's congress of Guangdong province has added auditors in its budgeting committee.
9. What factors affect the feasibility of reforming the current government auditing system?
10. What difficulties or obstructs will the reform of the government auditing system encounter?
11. What possible changes will take place in audit work if the current government auditing system is reformed?

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