HISTORY OF AUDIT IN CHINA

Chief Editor: *Li Jinhua*

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Li Jinhua is the Auditor General of the National Audit Office of the People's Republic of China. He was born in Rudong County, Jiangsu Province, in July 1943, and is a member of the 15th and 16th CPC Central Committee. He has an extensive background in theoretical research along with practical experience in finance, economics and auditing. He is a guest professor at Beijing University, Nankai University, Central University of Finance and Economics and Nanjing Audit University. He has written and compiled several specialized studies on finance, corporate management, financial accounting and auditing.

This volume records the evolution of audit in the People's Republic of China from its founding in 1949 to 2003. Focusing on the development of audit work at various stages, it also includes specific chapters on audit work in the People's Liberation Army (PLA), internal audit and public audit. Due to historical reasons, the audit systems in the Hong Kong Special Administrative Region, the Macao Special Administrative Region as well as Taiwan region of China are different from that in the mainland of China, and in view of this, special chapters are also designed to give an introduction to them.

Contents

Foreword

The *History of Audit in China* is a monumental work of history research on specialized subject in China. Spanning several thousand years from the ancient times to the present, the book systematically deals with the basic processes and patterns in the history of audit work in China, including the origin and development of audit in all historical periods. It features a pioneering spirit in the field of special subject history research, a rigorous approach to history writing in its comprehensive, fact-based research on the history of audit in China and a history-writing logic in its research on the division of historical periods with an emphasis on important historical periods.

The first volume of the *History of Audit in China*, published in January 2004, adopts a basic research pattern of taking audit organization system and legal system building as the vertical line and audit modes, methods and related audit activities as the horizontal line in an effort to show the splendid historical achievements of audit work in ancient China. This is true of the exploration of the source of audit in the Xia, Shang and Zhou dynasties, the textual research and analysis of the formation of the "general assessment"[1] system in the Spring and Autumn and Warring States periods, the research on the censor system in the Qin and Han dynasties and the *Ministry of General Inspection*[2] system in the Tang and Song dynasties and the system of the *Court of Censors with Circuits*, which represented a sudden change in the Ming and Qing dynasties. Just as pointed out by Mr. Li Xueqin who wrote its foreword, the first volume "has shown practical

1. Also called Shangji system in Volume I
2. Also called Bibu system in Volume I

utilities of appraising the ancient times and knowing the present" in its research on the audit history of China over 3,000 years."

Divided into two parts, the second volume of the *History of Audit in China* presents a detailed study of the recent history of audit work in China. The first part is concerned with research on the audit history of the Republic of China. Based on historical facts, the authors give an objective account of the historical achievements of audit work during this period. Through a dialectic analysis, they also point out the basic problems that existed in the audit work during the period and examine them as a whole to reach scientific and fair conclusions. Specifically, the authors firstly give full recognition to the earliest audit organization system in recent China established by Sun Yat-Sen with "democracy and republic" as the goal. The same recognition is also given to the historical contributions made by Sun Yat-sen in creatively unifying economic supervision with audit. Secondly, the authors present a full review of the substantive progress in audit work during the periods of the Beijing Government and the National Government. In this conncection, they fully acknowledge the historical contributions made in this field by compatriotic intellectuals who had been educated abroad. Thirdly, the authors take the development of national industries and commerce in China as the background against which they devote a considerable space to the research on the public audit cause during this historical period and properly appraise its position and role in the society at the time. Fourthly, they provide a full review of the basic status of theoretical research on audit and research on practical matters in recent China and sum up the achievements scored at the time and the historical experiences that are worthy remembering. Finally, the authors use conclusive historical evidence and respectively reveal the basic problems that existed in the audit work during the periods of the Beijing Government and the National Government as well as the historical lessons which must be learned. These include problems of exaggerations in audit and corruption with audit officials, and the problem of good audit regulations "often becoming mere formalities" as pointed out by Mr. Yang Tianshi, who wrote the foreword for the second volume.

Part two of the second volume of the *History of Audit in China* presents a detailed description of the audit history of the revolutionary bases and liberated areas in China. It researches into and summarizes the historical experiences and achievements of innovative significance which the Soviet governments in the revolutioinary bases made in establishing audit organizations and an audit law system as well as in carrying out genuine financial and economic audit work. At the time, full consideration was given to the nature and Chinese characteristics of the Soviet governments. This was true of the budget and final account audit, routine internal audit, enterprise or other special audits and audit of social bodies undertaken by the central Soviet government. In varying degrees, these reflected the pioneering and innovative work in audit development during the period. Just as Mr. Yang Tianshi has pointed out, "'Review the old to get new inspirations'— Learning about yesterday and the day before yesterday is essential for us to grasp today and create tomorrow. " The second volume of the *History of Audit in China* tells us that: the achievements of audit work created by the Communist-led government from the Agrarian Revolutionary Period to the Liberation War Period undoubtedly laid the foundation for the development of the audit cause after New China was founded in 1949. It is clear that in its research, the *History of Audit in China* has scientifically handled the historical relationship in such a manner as to form a connecting link between the preceding and the following and carry on the past and open a way for future. This has enabled its research achievements to comply with the logic of historical development and reasonably integrate its research on historical issues with research on current and future audit issues.

The third volume, which is to be completed and go to press in the golden autumn of 2004, is a comprehensive, systematic and in-depth research on the history of audit development in modern China, with emphasis on the period of twenty years (1983-2003)since the reform and opening-up program began. Taking the splendid achievements of audit work in these twenty years as its basis for research, the whole book builds on a wealth of historical materials, conducts comprehensive research and describes the features of audit work development in China in a concise, objective and accurate manner. Specifically, the special features of the research as evidenced by the third volume of the *History of Audit in China* include the following:

1. The volume correctly sums up the achievements and experiences of audit work in a long process of development in China. Audit work has a long history in China. An evolutionary course of over 3,000 years has integrated China's audit culture and economic culture and even the whole Chinese culture into one body. From the ancient times to the present, audit supervision has been an important part of China's economic supervision system. The continuity, creativity and systematism that are shown in the history of audit development in China all naturally embody Chinese characteristics.

2. The research achievements of the third volume of the *History of Audit in China* show its position as a key volume of the whole book series. As far as the research on every important issue of audit history is concerned, the third volume can reflect the logic of the history in the development of audit work from the ancient times to the modern period. It can

also consistently reflect a pattern of evolution in line with the law of development of history.

3. Research in the third volume of the *History of Audit in China* represents a step further in the efforts to aim at objectivity and fairness which must be adhered to in the research on historical issues. For example, Chapter 1 indicates appropriately the influence of an inheritance nature that the audit cause in the revolutionary bases and liberated areas had on the audit work in the early days of the People's Republic of China. It also objectively describes the innovative progress made in the building of a unified audit system during the period of the planned economy. For another example, it fully recognizes the suitability of the financial audit and financial inspection activities in the early days of the People's Republic of China to the economic environment at the time while also factually affirming the historical progress made by the audit reforms in China during the economic system transition period.

4. In its research, the third volume systematically relates the audit reforms that were carried out during the period when a socialist market economic system was established. It describes the whole process of the fulfillment of macro audit reform goals, comprehensively sums up and gives full recognition to the historical experiences and achievements of audit reforms in China, and presents China's unprecedented progress in the development of modern audit to the Chinese people at home and abroad. This makes the research achievements of the third volume a scientific summary of the research work of the whole book.

5. On the basis of research on the general history of modern audit in China, the third volume of the *History of Audit in China* further conducts in-depth research on several special topics, including audit of the People's Liberation Army, internal audit and public audit. Thus, guided by the research principle of being heavy on the present and light on the past, it expounds, comprehensively and with focuses, the historical process and basic laws of modern audit development in China, and through special research on these special themes, highlights the innovative features of modern audit during the country's reform period. This is an important reason why the research achievements of the third volume have naturally become a research basis for the whole book.

6. In the design of a hierarchical research framework for the third volume of the *History of Audit in China*, a pattern of independent in-depth research on national audit (including government budget and final account audit, monetary audit and audit of state-owned enterprises), internal audit and public audit is formed. Moreover, in line with the principles of auditing science, a pattern of systematic research is also established from the perspective of establishing a modern audit supervision system based on the actually existing associated relationship among the three. Such a hierarchical design for audit research has

not only produced very good practical results but will also produce a major impact on future research on audit history.

7. Research in the third volume has convincingly applied the method of using historical cases in analysis and proof. This strengthens the power of historical evidence and improves the research results. For example, the use of case studies on state-owned enterprise audit and internal audit indicates that its research on historical issues and summarization of historical experiences have not only shown a strong relevance to the reality, but also well achieved the purpose of building the research work on firm historical evidence and proof.

8. The third volume conducts special research on the audit work in the Hong Kong Special Administrative Region, the Macao Special Administrative Region and Taiwan Region of China, which is of special historical research values and particular significance. Hong Kong and Macao are successful examples of the "one country, two systems" policy implemented by China. Both regions have also fully shown this feature in the development of their modern audit work. Taiwan is an inalienable part of China. Likewide, the modern audit work there shares an inseparable historical origin with that in the mainland. The third volume of the *History of Audit in China* attaches importance to special research on these parts, thus both embodying the research systematism and integrity of the book and objectively reflecting the uniqueness in the development of modern audit work in China.

The *History of Audit in China* which has evolved over 3,000 years is an important part of research on the history of economic and management development in China. It shines with the splendor of the Chinese historical culture and fully demonstrates the wisdom and talents of the Chinese people. From the *History of Audit in China* Vol.3, we can see the development of audit work through reforms and innovations in modern China, which has brought the audit cause to a new historical height. Moreover, we can also find in this volume an even more splendid future for audit work in the People's Republic of China. The logic of history is one of continuous innovations and development both at present and in the future. The research achievements of the *History of Audit in China* reveal to us this law of audit development in China. I heartily congratulate the grand publication of the whole *History of Audit in China* series and express my high appreciations to all the authors. Meanwhile, accepting the entrustment from the elder generation of the audit circles, I take great pleasure in writing this foreword to the book.

Guo Daoyang
Wuhan, October 2004

Chapter 4

Audit of the Chinese People's Liberation Army

The People's Liberation Army (PLA) is the armed group under the absolute leadership of the Communist Party of China (CPC), and an important part of the State power. The predecessors of the PLA under the leadership of the CPC were the Chinese Workers' and Peasants Red Army during the Agrarian Revolutionary War, the 8th Route Army of the National Revolutionary Army (called the 8th Route Army for short), later incorporated into the 18th Army Group, and the newly-incorporated 4th Army of the National Revolutionary Army (called the "New 4th Army" for short) during the Anti-Japanese War, and other people's armies led by the CPC. At the 7th Plenary Session of the 6th Central Committee of the CPC held on September 22, 1944, Liu Shaoqi, based on the fact that the regions under the control of the CPC were referred to as the "liberated areas," proposed calling the people's army led by the CPC the People's Liberation Army. In mid-October 1944, the Central Committee of the CPC and the Central Military Commission issued related directions in the name of the PLA. On November 1, 1948, the Central Military Commission issued an order that all military organizations under the leadership of the CPC were to be referred to as units of the Chinese People's Liberation Army.

PLA audit (hereinafter referred to as "military audit") is a form of economic supervision independently conducted in accordance with the law by the audit institutions and auditors of the army, on the accuracy, legitimacy and performance of financial revenues and expenditures, State assets, and other related economic activities carried out by troops, departments and other military units. The purpose of the military audit is to evaluate accountability, ensure the enforcement of financial and economic laws and disciplines, improve management, raise effectiveness and facilitate the healthy and orderly development of the economic activities of the army. Military audit is an important part of China's national audit.

Military audit originated during the Agrarian Revolutionary War. In September 1933, after the establishment of the Central Audit Commission of the Chinese Soviet Republic, the Military Audit Commission of the Red Army was set up, and staffed with inspectors. During the Anti-Japanese War (1937-1945), after the Red Army was incorporated into the 8th Route Army and the New 4th Army, the military audit organizations were restructured correspondingly. An audit department was formed under the Finance Committee of the Central Military Commission. The General Audit Commission was set up at the headquarters of the 8th Route Army. Each military area or division was required to set up an audit commission. Each brigade or sub-district, as well as unit at corps level was required to establish an audit team. A "three audits at three levels" system was established, with the preliminary audit at the corps level, a re-audit at the brigade or sub-district level, and a final audit at the level of division, military area or headquarters. After founding the Anti-Japanese Base of the Central Jiangsu Area in the north of Jiangsu Province, the New 4th Army also set up audit committees at three levels: the Central Jiangsu Area, sub-district and county. During the Liberation War (1946-1949), the PLA's military areas gradually perfected the audit system. In June 1949, the Logistics Department of the China Revolutionary and Military Committee promulgated the Provision System (Draft), the fourth chapter of which concerned the audit system. Through this document, PLA audit institutions and audit regulations were unified.

After the founding the People's Republic of China in 1949, military audit continued to follow the practices of the Liberation War period. In the initial period of the founding of the People's Republic of China, it had been put forward that a comprehensive PLA audit system should be set up. But the system was not established due to the War to Resist US Aggression and Aid Korea (1950-1953). Thereafter, China followed the example of the USSR in replacing the military audit system with a military financial supervision system. In May 1961, the PLA's General Logistics Department promulgated the PLA Audit System (Draft). However, it was not long before the military audit was suspended due to the "Cultural Revolution" (1966-1976). In July 1985, the Central Military Commission ratified the establishment of the PLA Audit Bureau (the name was changed to the PLA Audit Office in 1992). All Military Areas and all arms of the services then established their own audit bureaus or audit divisions. In January 1987, Deng Xiaoping, then Chairman of the Central Military Commission, signed the *Rules on PLA Audit Work (Interim)*. And in April 1995, Jiang Zemin, then Chairman of the Central Military Commission, signed the PLA Audit Rules. The legal status of military audit was thereby clearly defined, and military audit work was put on the track of standardization, regularization and legalization.

4.1 Military Audit Institutions

In the early days of the People's Republic of China, the General Logistics Department of the PLA set up an audit division in its Finance Department. The audit organs, separately conducting preliminary examination, review and final checking were set up in the units at or below the level of military area. In 1985 the PLA launched its the Audit Bureau (later called the Audit Office). Since then, all PLA general departments, military areas and armed services, and the armed police force have set up audit bureaus; and army groups, provincial military areas, and general groups of the armed police force, and some units at PLA division level have set up audit divisions.

4.1.1 Military Audit in the Early Days of the People's Republic of China

After the founding of the People's Republic of China in 1949, the PLA budget in the national finances steadily increased. In order to cope with this expansion, and with the ratification of the Central Military Commission, General Logistics Department Finance Office of the People's Revolutionary and Military Commission of the Central People's Government (called the General Logistics Finance Department for short) was formed on January 7, 1950, to guide and manage the finance and audit work of the PLA. In the early days of the People's Republic of China, the audit institutions at various levels virtually continued the practices, which were implemented in the Liberation War.