

Research on the Impact of Chinese Government Accounting Reform on Local Government Debt Management

Lili Yin

School of Heilongjiang Bayi Agricultural University, Daqing 163319, China.

Abstract

At present, the scale of local government debt in China is constantly expanding and risks are constantly rising, it is imperative to take effective measures to manage government debt and prevent and control debt risks. Government accounting reform is a powerful measure to strengthen the debt management of the local government in China. Based on the difficulties of local government debt management, this paper analyzes the major reforms of Chinese government accounting and analyzes the effects of government accounting reform on local government in terms of information supply, debt disclosure, and risk prevention and control.

Keywords

Local government; debt management; government accounting reform.

1. INTRODUCTION

In recent years, China's local government debt has been increasing, according to the China National Audit Office, as of June 2013, China's local government debt reached 10.89 trillion yuan, and by December 2017, the number had risen to 29.96 trillion yuan. The high growth rate of local government debt poses a huge threat to China's financial security. According to the <Chinese Government Balance Sheet of 2017> released by the Chinese Academy of Social Sciences, from 2010 to 2015, the total government liability increased from about 40 trillion yuan to about 70 trillion yuan, which increased by about 70% and about 100% in five years, the scale of liability grows faster. Chinese Premier Li Keqiang repeatedly mentioned in the <Government Work Report of 2019> that "prevention and control of local government debt risks", "securely handle local government debt risks, and prevent and control imported risks". One of the reasons for the growing size of local government debt is the incompleteness of the Chinese government accounting system. Therefore, to improve the level of China's local government in managing debt and preventing debt risks, it is imperative to reform the Chinese government's accounting system and implement accrual-based accounting. In 2015, China's Ministry of Finance issued <Government Accounting Standards -- Basic Standards>, standardized the new government accounting system of "double basis, double target, and double report". The reformed government accounting system implements a dual accounting method of financial accounting and budget accounting, which can provide comprehensive, authentic, and comparable accounting information for local government debt management, credit evaluation, and risk prevention.

2. CURRENT STATUS OF LOCAL GOVERNMENT DEBT

2.1. Concept of Local Government Debt

Local government debt refers to the debt formed by the local government by issuing bonds and borrowing from foreign governments or financial institutions. In essence, the government guarantees its own credit and promises to repay the principal and interest due to establish a

credit relationship with creditors to raise funds. The behavior of the government is a special way of distributing social funds and regulating the economic operation of the government. According to the different forms of local government debt, it can be divided into explicit debt and implicit debt.

2.2. Explicit Debt of Local Government

Generally speaking, the explicit local government debt is the part that is integrated into the local debt management system and needs to be repaid with financial funds, such as national debt or local government bonds. Starting in 2014, China began to implement limited management of local government debt, the scope of management is limited to explicit debt. The bonds issued by the government include general bonds and special bonds. The general bonds are used for the daily operation of government agencies, and the special bonds are used for special purposes, such as the construction of highways and the development of medical and health services. Local governments issue general bonds and special bonds every year through public and targeted issuance. The issuance of local government bonds in China in the past five years is shown in Fig.1 [1]. The balance of local government debt in China in the past five years is shown in Fig.2 [1].

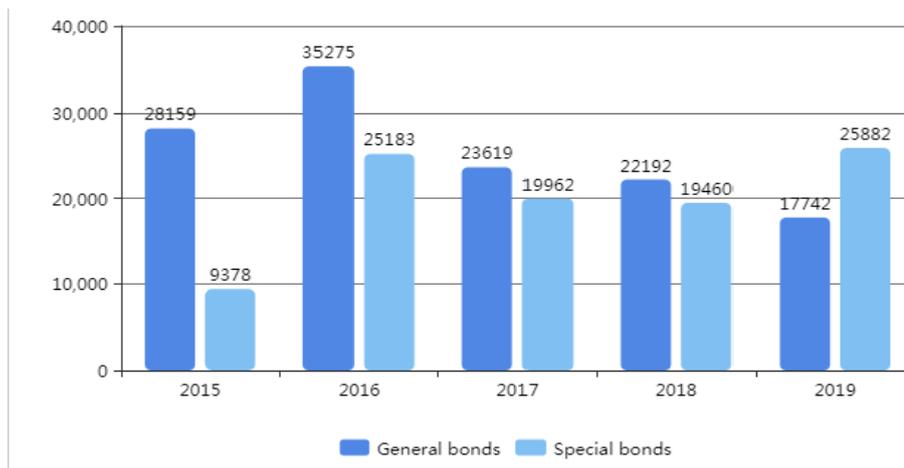


Fig 1. The amount of local government bonds issued in China from 2015 to 2019

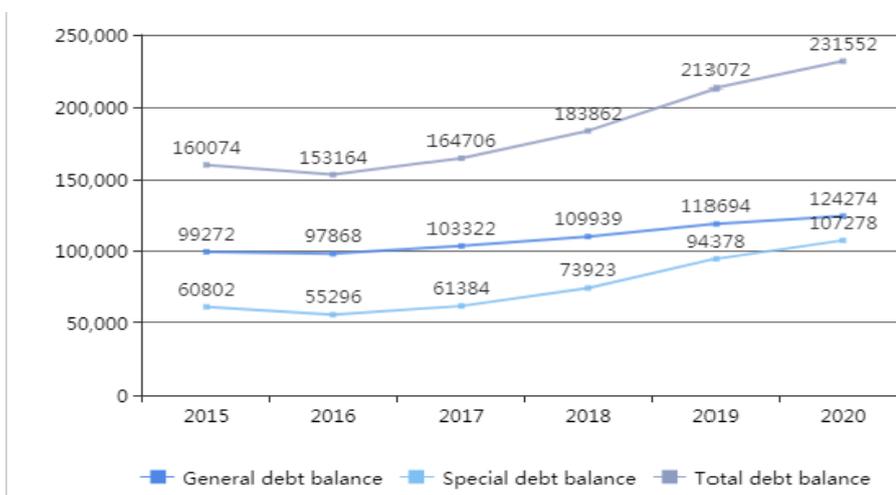


Fig 2. The local government debt balance in China from 2015 to 2020

2.3. Implicit Debt of Local Government

The implicit debt of local government is not included in the unified debt management system. It is the funds raised by the local government through illegal financing and illegal guarantees, or debts that are not bound by the contract but the government cannot relinquish responsibility, such as the placement costs of laid-off employees of state-owned enterprises. Compared with explicit debt, the amount of implicit debt is larger and the statistical difficulty is greater. There are many sources of implicit debt, and different types of implicit debt have different risks. The first type is the debts borrowed by various administrative institutions and repaid by financial funds. Usually, such debts have a definite loan contract, and the main body of both parties is clear, with minimal risk and controllable. The second type is the debt borrowed by state-owned enterprises and repaid by financial funds. It is more difficult for local government to supervise the use of this type of debt funds, and the probability of default risk increases. However, this type of debt is usually used for projects designated by the government, so risk can be controlled to some extent. The third is borrowed by state-owned enterprises and guaranteed by local governments. The responsibility for such debts is unclear. The government's supervision of the use of funds is further weakened. The government usually realizes its guarantee responsibility when the enterprise defaults, which risk is greater. The last type is the debts formed by local governments when they carry out PPP projects or purchase services by the government and promise to guarantee the minimum income. Such debts are often of huge capital amount, with long project term and many uncertainties, which have a great impact on government financial resources and credit. Therefore, these debts have the highest risk [2]. The types and risks of implicit local government debt are shown in Table 1.

Table 1. Types and risks of implicit debt of local government

Numble	Debtors	Repayer	Risk level	Risk controllability
1	Administrative units and institutions	Fiscal funds	IV(min)	Controllable
2	State-owned enterprises	Fiscal funds	III(larger)	Relatively controllable
3	State-owned enterprises	Guaranteed by local government	II(significant)	Uncontrollable
4	Third-party enterprises	Local government	I(max)	Completely uncontrollable

3. DIFFICULTIES OF LOCAL GOVERNMENT DEBT MANAGEMENT IN CHINA

3.1. Distorted Information on Local Government Debt

Under the budget accounting system based on the realization of receipt and payment system, the recognition of liabilities is synchronized with the cash flow, regardless of the accounting period in which the business occurs, such as government loans and bonds issued. It is regarded as government debt only when cash received. If no cash is received, no accounting will be done. Under this accounting method, the debt information is lagging, and it cannot reflect the actual total debt amount of the current period. It is difficult to manage the debt risk promptly. However, it provides space for local governments to manipulate their debts and whitewash their performance during the ruling period. Also, under the budget accounting system, government debts are accounted for in the income category, and the debt balance is reflected in the budget balance category, which confuses the connotation of liabilities and balances and leads to the generation of untrue debt information from the source [3].

3.2. One-sided Disclosure of Local Government Debt

Former government accounting objective is to meet the needs of government budget management, the use of the reaction of local government financial resources without assessment financial condition, and the effect of the government's economic management. Therefore, only the explicit debt data of local governments are counted, but implicit debts are not counted, for example, the social security projects to be paid in the future, the arrears of the public administration department, the wages of employees that should be paid but not paid, etc. The one-sidedness of debt information disclosure prevents the government from grasping the comprehensive debt situation of local governments. Moreover, the data is scattered in different statistical tables of the China National Audit Office, the Ministry of Finance, and the National Statistics Bureau, and there are differences in multi-caliber statistics, which has aggravated the difficulty of the government to conduct market supervision and macro policy formulation.

3.3. Inconvenient to Manage the Risks of Local Government Debt

The core of risk management is risk prevention and control, but at present, the debt information of local governments lacks authenticity and incompleteness, and cannot faithfully reflect the scale and structure of debts and the solvency of local governments, neither can effectively prevent and control debt risks. Poor risk prevention and control are not only ineffective to debt management, but also leads to the expansion of government losses when risks occur [4].

4. CHARACTERISTICS OF THE REFORMED GOVERNMENT ACCOUNTING SYSTEM

4.1. Double Basis

All government units in China implemented the complete cash basis before 2001, after the revision in 2001, accrual basis was used by some businesses. Under the cash basis, the confirmation time of business is based on the cash actually received or paid, while under accrual basis, subject to the period when business occurs. But the half-mixed accounting basis did not cause substantial changes in debt information, because only seven categories of matters are accounted for by accrual basis on annual closing. The major reform of the government accounting system is the change of accounting basis, from the half-mixed basis into the "double basis", which means government budget accounting adopts the cash basis, while government financial accounting adopts the accrual basis. For all business operations in the government, financial accounting is performed first, and budget accounting is performed only when budget management is met and cash changes occur.

4.2. Double Purpose

In addition to the competent agencies, legislatures, and the general public, users of government debt information include creditors, evaluation agencies, etc. Each user has different purposes for information, but the demand for government financial status and performance is more extensive. The reform of government accounting is to meet their urgent needs for government financial accounting information. Therefore, the "double purpose" is the starting point of the government accounting reform. On the one hand, it satisfies the budget management needs of government and competent departments through budget accounting, on the other hand, it reflects the government's financial situation and economic performance through financial accounting.

4.3. Double Report

The double report refers to the preparation of the government's comprehensive financial report based on the accrual basis and the government finalization report based on the cash basis at the end of the year. The government's comprehensive financial report includes balance sheets, income, and expenditure statements, cash flow statements, and notes, which can reflect the financial status of local governments. The double reporting system can satisfy the information needs of different users and provide a basis for debt analysis and risk management.

5. THE IMPACT OF GOVERNMENT ACCOUNTING REFORM ON LOCAL GOVERNMENT DEBT MANAGEMENT

5.1. Enhance the Authenticity of Government Debt Information

Distorted and lagging debt information will affect the judgment of the management authorities, leading to policy deviations and improper market regulation. After the government financial accounting adopts the accrual basis of accounting, regardless of whether cash income or expenditure occurs, as long as there is a change in liabilities, the accounting treatment will be carried out. For example, the issuance of new debts, the payment of debts, and the payment of debt interest will all be reflected in financial accounting immediately. Real debt information is a prerequisite for local governments to manage debt and is an important basis for decision-making. It is helpful for local governments to compare debt information horizontally and vertically, also convenient for the central government to evaluate the performance of local governments.

5.2. Improve the Comprehensiveness of Government Debt Disclosure

After the reform of government accounting, the local government debt situation is more comprehensive reflective through the government financial account of liabilities. On the one hand, it reflects the government's explicit debt through the accounts of government bonds-payable, loan payable, and long-term payable. On the other hand, the government's implicit debt can be reflected by short-term and long-term borrowing, fiduciary liability, especially the government's contingent liabilities can be reflected by "anticipation liabilities" account, which greatly expanded the scope of government debt disclosure. Comprehensive debt disclosure provides convenience for risk management and supervision, accurately grasp the government's financial resources and fiscal sustainability.

5.3. Improve the Prevention and Control of Local Government Debt Risks

Several teams in China have researched the application of government comprehensive financial reporting, and based on the relevant asset and liability information provided by government financial accounting, they have built a local government debt analysis system to carry out effective risk prevention and control. Firstly, using the balance sheet data to calculate and analyze the solvency of local governments, such as the quick ratio, current ratio, asset-liability ratio, interest repayment multiple, and other indicators. Secondly, collecting statistics of local government debt on the types, structure, scale, and maturity. Thirdly, conducting debt limit management by comparing the debt scale and fiscal revenue and expenditure [5].

6. CONCLUSION

Local government debt promotes infrastructure construction and local economic development, but a large amount of debt threatens China's financial security. After the government accounting reform, China's local governments have made great progress in debt management, but there are still many hidden debts that cannot be disclosed in accounting. To establish a

healthy and sustainable government debt management system, a concerted effort from multiple departments is also necessary.

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