
The Legal and Accounting Environment of the Non-Profit Organisations of China

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Abstract

This paper examines how the Chinese centrally planned legal/accounting environment associated with a non-profit sector facilitates the maintenance of tight government control in a rules-based setting. This study also shows how the legal milieu organises civil society and normalises the processes of Chinese not-for-profit services, particularly through state regulations and the use of accounting information. It appears that strict legislation on the accounting regulations and administration of Chinese not-for-profit organisations has the potential to compromise the activities and independence of not-for-profit organisations.

Introduction

The accounting/legal environment¹ of the Chinese not-for-profit system is considered at length in this study. Informed primarily by the work of Yee,² the paper attempts to understand the political and ideological influence of the state upon Chinese non-profit organisations (NPOs). More specifically, the paper considers how the present political ideology of the Chinese leadership draws upon regulations and accounting in the development of the not-for-profit system.

The NPOs of the People's Republic of China (China), including academic organisations, arts and literature groups, charitable organisations (mutual help societies, associations and orphanages), churches, foreign missions, private schools and colleges, and professional associations (guilds, societies and chambers of commerce), are independent organisations created for the public good.³ NPOs in China are growing in number. Chinese NPOs have increased⁴ from approximately 6000 registered groups in 1999 to about 150 000 in 2005.⁵

¹ The legal milieu refers to surrounding legal arenas of thought and political struggle that have bearing on the subject considered (M J Radin, 'A Comment on Information Propertization and its Legal Milieu' (2006) 54(23) *Cleveland State Law Review* 23); the accounting milieu refers to the surrounding accounting arenas of thought and political struggle (A M Brown, 'The Milieu of Reporting of Nacamaki and Nabuna Villages of Koro Island' (2009) 21(3) *Pacific Accounting Review* 202).

² H Yee, 'The Re-emergence of the Public Accounting Profession in China: A Hegemonic Analysis' (2009) 20 *Critical Perspectives on Accounting* 71.

³ T H McCallie III, *Nonprofits in China* (21 August 2005) ChinaSource <<http://www.chsource.org/site/en/contemporary-culture/285-nonprofits-in-china.html>>.

⁴ J Xijin and Z Yusi, *Five Characteristics of the Development of Chinese Non-Profit Organizations* (7 January 2009) Policy Forum Online 09-002A <<http://www.nautilus.org/publications/essays/napsnet/forum/2009-2010/09002XijinYusi.html>>.

⁵ Mark Yu-Ting Chen, Lincoln J Pan and Hai Wu, *Developing China's Nonprofit Sector* (August 2006) McKinsey and Company <http://www.mckinsey.com/locations/greaterchina/mckonchina/industries/Public_Sector/developingchina.aspx>.

Many NPOs have their origins in social organisations from the Sui, Tang and Song Dynasties.⁶ After the Communist takeover, most NPOs were disbanded or absorbed by the Party or government.⁷ They then became government organised non-governmental organisations (GONGOs).⁸ Presently, the Chinese NPO sector consists of social organisations (*shehui tuanti*), foundations (*jijinhui*), and private non-enterprise units (PNUs) (*minban fei qiye danwei*).⁹ Social organisations are NPOs that are voluntary in basis and pursue the membership's common goals,¹⁰ typically taking the form of an academic society, charity, industrial association or research unit.

By contrast, privately-run PNUs are not-for-profit social service organisations that are formed by not-for-profit government institutions, individual citizens and social entities.¹¹ These civilian-run, non-enterprise units are supervised by the Ministry of Civil Affairs and typically provide education, hygiene, culture, science and technology, sports, labour, civil administration, agency and legal services on a non-profit-making basis.¹² The foundation is a non-government organisation that is formed by funds donated by overseas or domestic individuals or organisations¹³ and mostly promotes cultural education, scientific research, social development and social welfare.

⁶ McCallie, above n 3.

⁷ Ibid.

⁸ F Wu, 'Environmental GONGO Autonomy: Unintended Consequences of State Strategies in China' (2003) 12(1) *The Good Society* 35.

⁹ Leon E Irish, Jin Dongsheng and Karla W Simon, *China's Tax Rules for Not-For-Profit Organizations* (2004).

¹⁰ *Regulations on the Registration and Administration of Social Organisations*, 1989.

¹¹ *Provisional Administrative Regulations Concerning Registration of Privately-run Non-enterprise Units, 1998*, promulgated by Decree No. 251 of the State Council of the People's Republic of China on 25 October 1998.

¹² Tax exemption is granted for qualified tax exempt income (for example, financial aid from the government, various fees collected under governmental approved fee scales and donations from the society).

¹³ *Regulations for the Management of Foundation*, issued by the State Council on 27 September 1988.

This study makes some important contributions. First, it demonstrates how a centrally planned legal/accounting environment associated with a non-profit sector may facilitate the maintenance of tight government control in a rules-based setting. The paper shows how China's legal and accounting power relations have maintained the state's centralised regulatory hold over not-for-profit organisations for the benefit of its government. Secondly, the study shows how the legal milieu organises civil society and normalises the processes of Chinese not-for-profit services, particularly through state regulations and the use of accounting information.

The paper is structured as follows. The next section outlines Yee's theory of central control.¹⁴ This is followed by a section setting out the Chinese laws embedded in the not-for-profit sector. The next section explains the political and social practice of accounting in the Chinese not-for-profit sector, focussing in particular on the calculative practices of documentation and audit. The final section outlines the paper's conclusion and the implications of the study.

Theory of Power Relations

Brown has demonstrated the way in which an industry's carefully planned legal/accounting environment can facilitate the maintenance of the perception of high quality produce and exacting standards in a domestic setting.¹⁵ The classification and communication inherent in the accounting practices deployed in such systems have the potential to construct identities, inform perceptions of quality, and impact on the social relationships of a specific market. Yee has considered this legal/accounting nexus in terms of its relationship with the state.¹⁶ This paper attempts to extend the use of the legal/accounting/state relationship to investigate the link between Chinese state controls and the Chinese not-for-profit sector.

¹⁴ Yee, above n 2.

¹⁵ A M Brown, 'The Legal/Accounting Milieu of the French Wine Industry' (2010) 12 *Legal Issues in Business* 11-18.

¹⁶ Yee, above n 2.

Gramsci and Yee have explained civil society and political society in terms of power relations.¹⁷ Political society represents influential relations, which are manifest in state institutions (such as the armed forces, government, law and the police) that exercise direct domination through the 'monopoly of coercion' and 'legal' enforcement on groups that do not comply.¹⁸ This coercion may be typically exercised through the use of legislation.

By contrast, civil society comprises organisations such as churches, cultural entities, media, political parties, schools, trade unions and voluntary associations which are distinct from the process of production and from state coercive apparatuses, but which build political and social consciousness.¹⁹ The accounting profession may be seen as a part of civil society, although some commentators, commenting on Western scenarios, suggest that the accounting profession reflects the power relations of both civil and political society from the state's 'monopoly of coercion'.

In terms of China, Yee found that the relationship between the state and the accounting profession reflected a Confucian notion of a vertical and unequal relationship, where mutual but complementary obligations arose in terms of benevolence and obedience.²⁰ This relationship provided a nurturing environment for Chinese accountants reflected by the government's concern for the development of accounting and the government's recognition of the accountants' role in China's economic reforms. Yee also concluded that, in recent times, the Chinese accounting profession had gathered considerable ideological and legislative backing from the government, with the state supporting the development

of the accounting occupation. Chinese accountants responded positively to the state's 'nurturing environment'.²¹

The Legal and Accounting Environment of Chinese NPOs

One form of NPO is the non-governmental organisation (NGO), created by people who are not part of the government.²² The Chinese government permits both domestic and foreign NGOs to operate in China, although foreign NGOs experience a lack of stable connections with the Chinese government.²³ In recent times NGOs have experienced tighter censorship of the internet, close inspection of some liberal newspaper editors and curbs on reporting,²⁴ together with tension between NGO demographers and the powerful control bureaucracy over the one-child policy.²⁵

Irish, Dongsheng and Simon note that the Chinese government realises that volunteer and non-profit organisations can contribute a great deal towards improving the lives of the poor and disadvantaged in China,²⁶ particularly given the growing problem of income inequality in China.²⁷ Among the specific regulations touching upon non-profit organisations, *Accounting Law 1999* represents the legal norms governing the accounting and administrative rules and regulations of all entities. *The Certified Public Accountant Law, Budget Law and Audit Law, Company Law, Law on Negotiable Instruments, Enterprise Bankruptcy Law, and Contract Law 1999* also form the

¹⁷ A Gramsci, *Selections from the Prison Notebooks* (Q Hoare and G N Smith trans, Lawrence & Wishart 1971); Yee, above n 2.

¹⁸ Yee, above n 2.

¹⁹ T R Bates, 'Gramsci and the Theory of Hegemony' (1975) 36(2) *Journal of the History of Ideas* 351; Roger Simon, *Gramsci's Political Thought* (Lawrence & Wishart, 1982).

²⁰ Yee, above n 2.

²¹ Ibid.

²² Some jurisdictions narrowly define NPOs to mean entities that use their extra funds for the entities' purpose, and NGOs to mean entities created by people who are not part of the government.

²³ Renee Yuen-Jan Hsia and Lynn T White III, 'Working Amid Corporatism and Confusion: Foreign NGOs in China' (2002) 31(3) *Nonprofit and Voluntary Sector Quarterly* 329.

²⁴ Banyan, 'On the Defensive: A Bad Attack of the Jitters Among Chinese Leaders, and Dissidents Pay the Price' (2011a) 9-15 April *The Economist* 32.

²⁵ 'The Most Surprising Demographic Crisis' (2011b) 7-13 May *The Economist* 27.

²⁶ Irish, Dongsheng and Simon, above n 9.

²⁷ A Carroll, 'China at a Turning Point' (2011) 33(13) *Business Review Weekly* 16.

cornerstone of the legal system governing accounting work.

As shown in Table 1 below, the main regulations governing state-owned institutional units in the NPOs in the People’s Republic of China derive from the *Financial Rules of Institutional Units 1997* and the *Accounting Regulation of Institutional Units 1998*. Regulations governing private NPOs, including registered social organisations, foundations, private

non-enterprise units and monasteries and temples are derived from the *Accounting Regulations of Private Non-Profit Organisations 2005*. An exposure draft (*Accounting Regulations of Public Colleges and Universities 2010*) and an act (*The Accounting Regulations of Public Hospitals 2011*) regulate the accounting behaviour of colleges and universities, and hospitals, respectively.

Table 1 Contemporary Legislation Relating to Chinese Non-profit Organisations: The Accounting Link

Regulation name	Financial Rules of Institutional Units (public non-profit organizations)	The Accounting Regulation of Institutional Units (public non-profit organizations)	The Accounting Regulations of Private Non-Profit Organizations	The Accounting Regulations of Public Colleges and Universities (Exposure Draft)	The Accounting Regulations of Public Hospitals (Exposure Draft)
Date	1 January 1997	1 January 1998	1 January 2005	August 2009; July 2010 (amended)	August 2009; July 2010 (amended)
Purpose	To regulate the financial behaviour and strengthen the financial management of institutional units, improve the efficiency of funds, maintain operating health of institutional units	To regulate accounting in state-owned institutional units	To regulate accounting in private non-profit organisations, ensure the truthfulness and fullness of accounting information	To regulate the accounting behaviour of colleges and universities, ensure the quality of accounting information	To regulate accounting in hospitals, ensure the truthfulness and fullness of accounting information
Accounting entity	State-owned institutional units in the People’s Republic of China	State-owned institutional units in the People’s Republic of China	Private non-profit organisations established in the PRC, including registered social organisations, foundations, private non-enterprise units and monasteries, temples, mosques, churches	Full-time colleges and universities, adult colleges and universities held by governments at all levels. General secondary schools, technical schools, adult secondary specialised schools	All kinds of public medical institutions, including general hospitals, special hospitals, outpatient departments, nursing homes, community hospitals, etc. in the PRC

Regulation name	Financial Rules of Institutional Units (public non-profit organizations)	The Accounting Regulation of Institutional Units (public non-profit organizations)	The Accounting Regulations of Private Non-Profit Organizations	The Accounting Regulations of Public Colleges and Universities (Exposure Draft)	The Accounting Regulations of Public Hospitals (Exposure Draft)
Catalogue of regulations	(1) Introduction (2) Budget management of state-owned institutional units (3) Revenue management (4) Expenditure management (5) Balance and allocation (6) Special fund management (7) Asset management (8) Liability management (9) Liquidation of institutional units (10) Financial reporting and financial analysis (11) Supplementary provision	(1) Introduction (2) Accounts of institutional units (3) Accounting instructions (4) Year-end clean-up, settlement and closing the books (5) Preparation of financial statement	(1) Introduction (2) Asset (3) Liability (4) Net assets (5) Revenue (6) Expenditure (7) Financial statements	(1) Introduction (2) Name and code of accounts (3) Accounting instructions (4) Financial statement format (5) Introduction of financial statement preparation	(1) Introduction (2) Name and code of accounts (3) Accounting instructions (4) The preparation of budget information (4) Financial statement format (5) Financial statement preparation
Accounting base	Cash basis	Cash basis	Accrual basis	Modified accrual basis	Accrual basis
Basic accounting assumptions	Accounting entity assumption The going concern assumption Accounting period assumption Assuming monetary measurement	Accounting entity assumption The going concern assumption Accounting period assumption Assuming monetary measurement	Accounting entity assumption The going concern assumption Accounting period assumption Assuming monetary measurement	Accounting entity assumption The going concern assumption Accounting period assumption Assuming monetary measurement	Accounting entity assumption The going concern assumption Accounting period assumption Assuming monetary measurement
Accounting elements	Asset Liability Net assets Revenue Expenditure	Asset Liability Net assets Revenue Expenditure	Asset Liability Net assets Revenue Expenditure	Asset Liability Net assets Revenue Expense Budgetary revenue Budgetary expenditure Balance of budgetary revenue and budgetary expenditure Accumulated balance	Asset Liability Net assets Revenue Expense Budgetary revenue Budgetary expenditure Balance of budgetary revenue and budgetary expenditure Accumulated balance

Regulation name	Financial Rules of Institutional Units (public non-profit organizations)	The Accounting Regulation of Institutional Units (public non-profit organizations)	The Accounting Regulations of Private Non-Profit Organizations	The Accounting Regulations of Public Colleges and Universities (Exposure Draft)	The Accounting Regulations of Public Hospitals (Exposure Draft)
Financial report	Balance sheet Statement of revenue and expenditure Notes to the financial statements Statement of financial condition	Balance sheet Statement of revenue and expenditure Notes to the financial statements Statement of financial condition	Balance sheet Statement of activities Cash flow statement Notes to the financial statements	Balance sheet Statement of revenue and expense Budgetary statement of revenue and expenditure Statement of capital construction and investment Notes to the financial statements	Balance sheet Statement of revenue and expense Statement of medical revenue and expense Budgetary statement of revenue and expenditure Statement of capital construction and investment Notes to the financial statements

As depicted in Table 1, political society (regulations) and civil society (accounting entities, elements and reports) are deeply entwined with each other. Thus, for example, *The Accounting Regulations of Private Non-Profit Organizations* requires private Chinese non-profit organisations (which include registered social organisations, foundations, private non-enterprise units and monasteries, temples, mosques, churches) to use an accrual basis of accounting,²⁸ to provide information on the NPO's assets, liabilities, net assets, revenue, expenditure and financial statements. Such financial statements include a balance sheet,²⁹ statement of activities,³⁰ cash flow statement³¹ and notes to the

financial statements.³² Akin to International Accounting Standards, the general accounting principles or concepts used in China's accounting regulations, called the Accounting Systems for Business Enterprises (ASBE), include accuracy, completeness, consistency (the historical cost convention is used for measuring assets), comparability (records in accounts and books have to be made in renminbi or yuan), timeliness (balance day is December 31), materiality, accrual basis, matching, prudence, substance over form (fair market values are seldom used because of the limited existence of open markets), and going concern.

Provisions contained in this regulation apply to all types of legal private not-for-profit organisations in China, including social organisations, foundations and private non-enterprise units. The main body of this regulation consists of specific technical rules and instructions on disposition, evaluation and disclosure of accounting information. All accounting elements, such as assets,

²⁸ An accrual basis of accounting, as distinct from a cash basis of accounting, recognises the effects of transactions and events in the accounting records when they occur, rather than when cash or its equivalent is received or paid.

²⁹ A balance sheet is a financial statement listing the assets, liabilities and equity of an entity at a specific date.

³⁰ An NPO's statement of activities is akin to a business's income statement. The statement of activities focuses on revenues such as contributions, grant, investment income, membership dues, and program fees. Expenses are reported in categories such as fundraising, general, major programs and management.

³¹ A cash flow statement (also known as funds flow statement or statement of cash flows) is concerned with the flow of cash in and out of the entity. It shows how changes in balance sheet accounts and income affect cash and cash equivalents.

³² Note that under the Accounting Laws, the Regulations on Financial Reporting of Enterprises and the ASBE, financial statements or reports should comprise a balance sheet, profit and loss accounts, cash flow statements, notes to the accounts and a profit and loss appropriation account. The regulations also cover classification of assets and liabilities in the balance sheet.

debts, owner's equity, inventory, short-term investments and long-term investments are covered. It also specifies clear requirements for activities like the distribution and use of a non-profit organisation's funds and resources; compilation of basic statements of accounts; and disclosure of financial reports. In this sense, this Regulation plays a basic role in the accounting of a non-profit organisation which is similar to the adopted accounting standards in the accounting of a business. It thus appears that the China Ministry of Finance (MOF) published the *Accounting Regulation of Civil Not-For-Profit Organizations* as an attempt to standardise the accountancy of private non-profit organisations and to improve the quality of accounting information.³³

Implications for Civil Power

There are difficulties in allowing unequal relationships between political and civil society in the context of the administration of Chinese NPOs. These include a dependence on government, unbound and strict legislation on NPO accounting regulations and administration, inflexible rules and a lack of capital and resources,³⁴ and weak management skills.³⁵

Examples of this unequal relationship are captured by Bentley.³⁶ Historically, the Chinese government and Communist Party have long regarded civil society entities with suspicion because the government saw little value in intermediate organizations between the party/state and 'the masses', apart from a handful of 'mass organizations' run by the party/state, such as the All-China Women's Federation and the All-China

Federation of Trade Unions. The development of civil society is particularly sensitive in China because of the government's concern that civil society entities may have political motives adverse to the existing system.

In terms of the NPOs' strict accounting regulations and administration, it appears it is incumbent on Chinese NPOs to have at least one representative who is competent in the techniques of accounting. This is a particularly onerous expectation given the nature of China's emerging economy and strong competition from the profit sector for accounting personnel.

It is salient to note that NPOs serve as intermediaries between community and government, communicating information about the needs of groups in the community to governments that would otherwise remain uninformed. Such organisations provide a voice for marginalised groups, create deliberative forums, provide channels for consultation, and encourage public debate by providing information and opinions that would otherwise not be heard. The legitimacy of NGOs is granted by the communities they represent and it is to these same communities that they must be accountable. An example of this occurred in 2003 with the outbreak of the Severe Acute Respiratory Syndrome (SARS). Many NPOs, particularly health care workers, responded to the crisis more quickly than the government by setting up counselling hotlines for the public and health care workers, and by disseminating SARS prevention information and actively seeking out those with SARS.³⁷

The fusion of the civil (accounting) with the political (legislation) may encourage non-profit organisations to adopt the practices of profit-oriented enterprises. When practices are treated this way, it appears legitimate to write contracts that prevent NPOs from engaging in public comment and to treat NPOs as self-interested

³³ H Shi, *Accounting Regulation of Civil Not-For-Profit Organization in China* (trans, 2003) China Ministry of Finance (MOF).

³⁴ X Zheng and Q Ren, 'The Researches on Non-Profit Organization's Internal Controlling' (Working Paper, Chongqing University, 2010) <<http://www.seiofbluemountain.com/upload/product/201001/1264386514astf39sq.pdf>>.

³⁵ Chen, Pan and Wu, above n 5.

³⁶ J G Bentley, 'Survival Strategies for Civil Society Organizations in China' (2004) 6(2) *The International Journal of Not-for-Profit Law* <http://www.icnl.org/knowledge/ijnl/vol6iss2/art_1.htm#_edn16>.

³⁷ D H C Hsin and D R J Macer, 'Heroes of SARS: Professional Roles and Ethics of Health Care Workers' 2004 49(3) *Journal of Infection* 210-215.

entities. Further, it is tempting to measure NPO performance according to accounting numbers (for example, on the basis of earnings) rather than service delivery.

As a result of this shift many disadvantaged groups that have taken years to organise themselves sufficiently to have a voice may find themselves increasingly excluded from the policy-making process. Gjems-Onstad notes that in a Norwegian NPO setting, tactics employed included freezing out and decreasing funding for uncooperative NPOs, use of intimidatory economic/accounting methods (for example, stricter overview of accounting records and close monitoring of financial statements), and micro-management of relationships between the government and peak organisations (for example, intrusion into the recruitment and training of volunteers).³⁸

A further implication for NPOs in the unequal relationship between political and civil society is that the absence of an adversarial relationship between NPOs and the government may diminish the independence of the NPO, thus making it difficult to fulfil the aims of the organisation. Gjems-Onstad sees not-for-profit organisations as a set of individuals joined together to pursue certain objectives or interests usually initiated by private persons, *not* by government authorities. They are directed on a private and voluntary basis. The main objective is not to gain profit but to achieve not-for-profit work through the voluntary work of members. The difficulty of having insufficient independence from a closely monitoring government is that NPOs may not use the full resources that fully independent voluntary organisations may possess.³⁹ Allied to this idea of independence is the link between the Chinese mass media and environmental

NGOs/NPOs, the 'NGO-ization of the media'.⁴⁰ Many of these environmental NGOs/NPOs are set up by Chinese journalists and environmentalists to reach a wider readership.⁴¹ Journalists' connections with government officials can be used to bring certain local environmental problems under the attention of the central government,⁴² but by ensuring economic independence of media outlets, journalists and environmentalists are able to exert pressure on the government to pay more attention to the environment.⁴³

The centrally-planned legal/accounting environment associated with the Chinese not-for-profit sector may, thus, interfere with the 'ownership' of the NPO (which typically may consist of a small number of people), increase the complexity of operations that ordinarily have few sources of revenue, place considerable pressure to comply with accounting rules on organisations that have members with limited financial/accounting expertise, and compromise an NPO's independence.

³⁸ Ole Gjems-Onstad, 'The Independence of Voluntary Organizations in a Social Democracy: Governmental Influences in Norway' (1990) 19(4) *Nonprofit and Voluntary Sector Quarterly* 393.

³⁹ *Ibid.*

⁴⁰ Y Lu, 'Environmental Civil Society and Governance in China' 2007 64(1) *International Journal of Environmental Studies* 59-69.

⁴¹ C Calhoun and G Yang, 'Media, Civil Society, and the Rise of a Green Public Sphere in China' 2007 21(2) *China Information* 211-236.

⁴² S Hoffer, *Negotiating the State? Influencing China's Role in International Climate Change Politics* (Masters Thesis, University of Amsterdam, 2009).

⁴³ A P J Mol and N T Carter, 'China's Environmental Governance in Transition' 2006 15(2) *Environmental Politics* 149-170.