

Legal Issues for the Reform of Budget Systems

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Introduction

As discussions on the national budget and accounting systems have recently been proceeding, introducing a multiple-year budget or a corporate accounting system has also been considered. While many study results concerning these issues have already been found in science of finance or accounting, their legal aspects have rarely been analyzed. Therefore, this thesis is intended to identify and categorize their legal issues as preparatory work for legal analysis¹⁾.

In the descriptions in this thesis, references are made to French laws, as appropriate. While the U.K., the U.S. and other countries adopting NPM (New Public Management) are frequently cited in other theses concerning the reform of budget and accounting systems, I consider it practical to make references to the French systems in order to establish a realistic reform theory in Japan, since France was the country of origin for the Japanese Public Accounting Law in the Meiji era (as well as Japan's existing Public Finance Law) and France's accounting system is behind in the performance-based system (result-oriented administration). In France, a new Organizational Law (*loi organique*) was enacted on August 1, 2001, stipulating basic principles, procedures and other items for budgets and settlements²⁾. This Organizational Law is almost equivalent to the Public Finance Law in Japan, but this new law contains various contents, unlike the former law, i.e., the January 2, 1959 Ordinance (*ordonnance*), and has a great impact on overall administrative operations. Since this Organizational Law is applicable in full force to the 2006 budget, the preparatory work is ongoing at present. In this regard, France is slightly more advanced than Japan.

Regarding the manner of descriptions in this thesis, the national-level budgets and accounting are principally targeted, and local finance is referred to when necessary. In addition, I have tried to make references to traditional issues regarding the Board of Audit of Japan in connection with the issues about today's policy evaluation.

Regarding the order of topics, the significance of financial democracy is briefly reviewed at first, followed by a review of various problems concerning budgets, settlements, accounting systems and audits. Lastly, supplemental problems are stated.

I. Significance of Financial Democracy

To establish a theory for studying the issues of public finance from the constitutional viewpoint, I would like to make minimum examinations of the significance of the financial democracy laid down in Article 83 of the Constitution.

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1) While expressed as legal issues, they are in fact the review points identified and categorized according to the author's own awareness of the issues, which are deemed common to the recent practical issues.

2) In Kimura, "Local Self-government Research (*Jichi Kenkyu*)", Vol. 78, No. 9, p. 57 (2002) as listed in References later, the Organizational Law enacted on August 1, 2001 in France is introduced and analyzed. This theme is later discussed in many theses, including "The Reform of Public Accounting System in France" by Yasuyoshi Kurokawa in *Government Auditing Review*, No. 28, p. 157 (2003), "French Economy in the Euro Era" by Takeshi Kurihara in *Finance*, August 2003 (No. 453), p. 351, etc.

1. Status of Theories

With respect to the purport of Article 83 of the Constitution, there are various conflicting theories as follows:

- (a) According to the traditional theory concerning the Constitution, it has been understood that Article 83 merely refers to a philosophy for financial operations and that the types and manners of resolutions or authorizations in the Diet are as per Article 84 and subsequent articles³⁾.
- (b) On the other hand, there has recently appeared a new theory to try to find out a positive legal significance in Article 83, in which this article is expected to supplement the efficiency of the provisions of Article 84 and subsequent articles⁴⁾.
- (c) In my view, Article 83 implies a democratic “control” other than the principle of “resolution” for finance. Among others, it implies a potential of “control by information.” In other words, Article 83 indicates that there are two models of financial democracy⁵⁾. In the following paragraph, these two models are explained in detail.

2. Two Models of Financial Democracy

- (a) According to the traditional theory, a “decision” regarding a budget made in the Diet is followed by “execution” of the budget under the accounting system (the Meiji era’s Public Accounting Law was in line with the French Public Accounting Law of the time, and the French term “exercice” on which the Japanese term “fiscal year” is based, implies the concept of the “execution” of budgets). This “decision and execution model” is based on the fiction that the functions of public finance will not start to work without a budget, and this model accords with the cash-basis budget and settlement system⁶⁾.
- (b) On the other hand, if we take the more realistic viewpoint, it is possible to consider that the functions of administration and public finance exist continuously (or must be maintained) and that budgeting and other involvements by the Diet therefore merely “control” the continuing functions of public finance in fragments indirectly. This “control model” is fit for private enterprises on an accrual basis relying on credit transactions.

Also, in the case of national and local governments, “credit transactions” may be made in practice before formal announcements and budget allocations, based on past transaction records. Especially, the continuous functions of public finance are required in economic activities such as supply contracts, service contracts, etc., where the same legal theory as to private enterprises basically applies.

Comparing these two models, the “control” model includes “decisions” in its concept and may contain various methods, in addition to “decisions” (inter alia, “monitoring and supervision by information” by the Diet by means of exercising the inspection right against administrative organs, requiring inspections of the Board of Audit of Japan, and others). Actually, it has been a recent trend in France to attach importance to other controlling methods than a budget.

Looking into the provisions of the Constitution again, it is not objectionable that Article 83 shows financial democracy. With respect to the types (the manner of supervision and involvement by the Diet) of financial democracy, however, there are the “decision and execution model” and the “control model.” Looking at the term “resolution” in Article 83, the former model will be derived, but I consider it logically possible to interpret this article in association with the latter model. As for its formal logic, it can be mentioned that Article 83 takes

3) Toshiyoshi Miyazawa, supplemented and revised by Nobuyoshi Ashibe, “Revised Edition: the Constitution of Japan (*Zentei Nihonkoku Kenpo*)” (Nippon-Hyoron-Sha, 1978), p. 709, and Masami Ito, “The Constitution (Kenpo), 3rd Edition” (Koubundo, 1995), p. 474.

4) Takemichi Hatakeyama, “Authority of the Diet for Public Finance”, a part of “The Structure of Modern Administrative Law (*Gendai Gyosei-ho Taikei*) 10 / Public Finance” edited by Ichiro Ogawa et al. (Yuhikaku, 1984), p. 28; Mitsuki Usui, “Financial System”, *Jurist* No. 1192 (2001), p. 193; and Ryuichi Arai, “Financial Democracy – from Constitutional Law”, a part of “Financial Democracy” edited by Japan Association of Public Finance Law (Gakuyo Shobo, 1994), p. 51.

5) Refer to Kimura, *Chihō Jichi*, No. 671, p. 9, as listed in References.

6) It appears that those who emphasize the budget circulation composed of budget-making, budget execution and settlement of accounts (Keiko Sakurai, “Legal Study of Public Finance” (Yuhikaku, 2001), p. 176, and Hisahiro Ishimori, “Legal Intention of Audit of Settlement of Accounts”, a part of “Points in Dispute about the Constitution, 3rd Edition”, in *Jurist Extra* Volume (1999), p. 271) also rely on the “decision and execution” model.

concrete shape in Article 91, in which “reporting” of the financial status to the Diet is deemed to satisfy the requirement of financial democracy.

It seems that the traditional theory have placed too much importance on the term “resolution” in Article 83 as a fundamental provision. This point affects various issues including, but not limited to, the propriety of the principle of independence of the fiscal year, the legal status of the Board of Audit, the manner of controlling subsidies and the principle of legislated taxation⁷⁾.

However, I have no intention to diminish the Diet’s control by narrowing the scope of resolutions. Instead, I believe that the importance of political control should be recognized in the field of public finance, in order to supplement the imperfection of judicial control⁸⁾.

II. Various Issues Concerning Budgets

While budgets have been actively discussed in respect of the formality of resolutions or the nature of their legal standards⁹⁾, I do not refer to such traditional issues here, but just mention the multiple-year budget control and other topics related to the present-day issues.

1. Concept of Budget

(1) Narrow definition and broad definition of budget

The “budget” in Article 86 of the Constitution is defined as (a) an estimate of revenues and expenditures in the common theory. In another theory, it is defined to mean (b) in addition to revenues and expenditures, the authorization of expenditure activities such as contracts resulting in Treasury obligation. According to a criticism from the viewpoint of (b), the definition of theory (a) cannot properly explain the point that a contract resulting in Treasury obligation is justified by a resolution for the budget¹⁰⁾.

However, a common theory says that a resolution is sufficient for a contract resulting in Treasury obligation and it is therefore satisfactory if we come to a conclusion from the interpretation of Article 85 of the Constitution that a contract resulting in Treasury obligation does not necessitate legislation, but just a resolution by the Diet, even without including such contracts in the definition of “budget.” Moreover, it has been considered a matter of fact that the assumption of the concerned obligation is authorized in a revenue and expenditure budget¹¹⁾, so the definition of “budget” and its effect can be distinguished.

Of course, it is possible to include factors, other than a revenue and expenditure budget, in the concept of the budget by virtue of the provisions of applicable laws, and if accrual-basis budgets are considered important, the broadly-defined concept shown by (b) will be more significant. Nevertheless, the significance of a narrowly-defined budget as shown in (a) will not be lost in that we can establish the concept of a cash-basis budget as a minimum requirement of the Constitution.

7) In addition to the subsequent descriptions in this thesis, refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 2, p. 102, as listed in References. According to Article 243-3.1 of the Local Autonomy Law, unlike Article 91 of the Constitution, reporting of financial status is addressed to citizens only, and this could be an obstacle for the interpretation explained in this thesis. However, I understand that this provision merely stipulates “disclosure” to citizens and does not preclude “reporting” to the assembly (yet it is desired that this provision will be amended for confirmation in principle).

8) Refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 2, pp. 97-99, as listed in References.

9) With respect to the issue concerning the formality of resolutions for budgets and their nature of legal standards, I mention the following thesis as one which served as a starting point of the discussions after WWII: Kazushi Kojima, “The Constitution and the Financial System” (Yuhikaku, 1988), especially, p. 184.

10) Sunao Kai, “Legal Structure for Supervision of Budgets and Public Finance” (Shinzansha, 2001), p. 1, raises a question about the popular definition of “budget”.

11) For example, see Tatsukichi Minobe, “Essentials of the Constitution (*Kenpo Satsuyo*), Revised 5th Edition” (Yuhikaku, 1925), p. 405, and Heiji Hirai, “A Treatise on Budgets and Settlement Systems” (Sojusha, 1948), p. 130. This statement leads to the “principle of obligation and payment in the same year”, as described below.

Consequently, I consider it appropriate to interpret the “budget” referred to in Article 86 of the Constitution as a narrowly-defined budget, by distinguishing a narrowly-defined budget (a budget in its inherent sense) and a broadly-defined budget (a budget under the Public Finance Law, or a budget in its formal sense).

(2) Cash-basis or accrual-basis?

One present-day issue is whether revenue and expenditure budgets on a cash basis can be replaced with those on an accrual basis. Administrative bodies have recently been preparing for financial statements from an accrual-basis standpoint, and the accrual-basis financial ruling, i.e., transition from a cash basis to an accrual basis, is being discussed. However, the possibility of renouncing cash-basis budgets and settlements has rarely been discussed in terms of the Constitution¹²⁾.

In my interpretation, cash-basis accounting is a constitutional requirement and the “budget” referred to in Article 86 of the Constitution means a revenue and expenditure budget on a cash basis. This is because of the purport of Article 85, the cash-basis terminologies in Article 90 (“expenditures and revenues”), and the importance of the right of resolving taxations on a cash basis, etc. These issues must be reviewed in association with the propriety of the principle of independence of the fiscal year as stated in the following paragraphs.

2. Principle of a Single-year Budget and Principle of Independence of the Fiscal Year

In order to examine whether accrual-basis budgets will be permissible under the Constitution, it is necessary to review the constitutional significance of the principle of a single-year budget and the principle of independence of the fiscal year¹³⁾.

(1) The difference between the principle of a single-year budget and the principle of independence of the fiscal year

While the principle of a single-year budget and the principle of independence of the fiscal year are often confused, the former is a principle that budgets must be resolved in the Diet each year (comprehensively resolving multiple years’ budgets is prohibited), and the latter is a principle that revenues and expenditures must be classified on a fiscal year basis and each fiscal year’s revenues must be used for the same year’s expenditures. Furthermore, the principle of a single-year budget can be considered independently from the form of the budget (cash-basis or accrual-basis, etc.), unlike the principle of independence of the fiscal year.

The principle of a single-year budget is considered to be based on Article 11 of the Public Finance Law which is subject to Article 86 of the Constitution. On the other hand, the principle of independence of the fiscal year is embodied in the provisions of Articles 12 and 42 of the Public Finance Law and others. As for exceptions to the principle of independence of the fiscal year, I mention the bringing forward of expenditure budgets (Article 14-3 and the proviso of Article 42 of the Public Finance Law), receiving of the previous year’s surplus (Article 41 of the Public Finance Law), funds specified in Article 44 of the Public Finance Law, etc.

(2) Constitutional basis for the principle of a single-year budget

It appears that Article 86 of the Constitution explicitly adopts the principle of a single-year budget. The prevailing theory also concludes without objection that this principle is interpreted as a constitutional requirement. However, Article 86 does not specify a period of the “fiscal year.” Therefore, it may be permissible under the Constitution to adopt fiscal years on a multiple-year basis, which can be found in the drafter’s intention in the process of preparing the Constitution to the effect that the principle of a single-year budget is not inevitably derived from Article 86 (this intention is shown in the different wording from Article 64.1 of the former

12) Even those who agree with the broad definition of “budget” under the Constitution consider it a rightful assumption that budgets under the Constitution are cash-basis budgets.

13)With respect to the principle of single-year budgets or the principle of independence of the fiscal year, refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 9, p. 147, and *Chiho Jichi*, No. 671, p. 3, both as listed in References; and Mitsuaki Usui, “Acceptability of the Budget on a Multiple-Year Basis or Multiple-Fiscal-Year Basis,” *Jichi Kenkyu* (2003), Vol. 79, No. 3, p. 3.

constitution). In my view, accordingly, the principle of a single-year budget is not a constitutional requirement and it is possible to set a fiscal year over multiple years and make a budget for those multiple years.

Considering the current status of the theories and actual budgeting work, however, it seems that there is a slight possibility to completely renounce the system of budget on a yearly basis. Therefore the following paragraphs are based on the principle of a single-year budget, even while recognizing that this principle can be renounced under the Constitution.

With respect to the multiple year-based management methods under the principle of a single-year budget, there are systems for contracts resulting in Treasury obligation, continuous expenditures, carry-over and long-term contracts, contracts which are practically on a multiple-year basis, etc.

(3) Significance of Article 85 of the Constitution

According to the general explanations in the applicable theory, the principle of a single-year budget is a doctrine under the Constitution and the principle of independence of the fiscal year is merely a principle under the law. However, I suppose that the principle of independence of the fiscal year could be as a result of Article 85 of the Constitution. In order to explain this, I first have to clarify the significance of this article.

According to the explanations in a commonly accepted theory, Articles 85 and 86 are common insofar as revenue and expenditure budgets are concerned, but Article 85 stipulates the substantial aspect of the budget which refers to the necessity of the Diet's resolutions and Article 86 stipulates a matter of formality in that a resolution must be made in the form of a budget. Consequently, it is said that Article 85 has its own significance only in respect of assumption of obligations other than revenue and expenditure budgets.

In my view, Article 85 stipulates a "principle of obligation and payment in the same year," so this article is interpreted as having its own significance in respect of such principle¹⁴. In other words, the former half of Article 85 is based on the principle that a contract resulting in certain obligations and the expenditures based on that contract will take place within the same fiscal year, in which case it is deemed sufficient to resolve such expenditures in the concerned budget. If it is intended from the beginning that a contract resulting in certain obligations and the expenditures based thereon will take place in different fiscal years, a separate resolution by the Diet is required, for example, in the form of a contract resulting in Treasury obligation (the second half of Article 85).

This "principle of obligation and payment in the same year" is proper, due to the substantial reason that the total amount of expenditures depends on the capacity of taxpayers' burdens in the concerned fiscal year and, thus, the whole of the nation's obligations (which is equal to the total amount of taxpayers' benefits, or the total amount of obligations assumed by the nation) must rely on that year's revenues (this explanation is based on the theory of tax for benefit, or the theory of tax for an exchangeable value of public service). The substantial reason stated above contains the purport of the principle of independence of the fiscal year. In this principle, revenues can be used for the same year's expenditures and no funding or mixture is allowed between different fiscal years' revenues and expenditures. That's why Article 85 of the Constitution can be the basis for the principle of independence of the fiscal year. At the same time, the "principle of collection and receipt in the same year" can also be derived by applying the "principle of obligation and payment in the same year" to revenues.

On the other hand, the second half of Article 85 allows exceptions for the "principle of obligation and payment in the same year," for example, in the form of a contract resulting in Treasury obligation. Therefore, exceptions for the principle of independence of the fiscal year are similarly allowed.

The purport of Article 85 of the Constitution, described above, is capable of explaining why the principle of a cash basis underlies the Constitution. The principle of a cash basis is a logical consequence of the principle of independence of the fiscal year, since it is defined to consist of cash-basis revenues and expenditures. It is true that the Constitution allows a legislative option for the fiscal year between a single-year basis and a multiple-year

14) For the relationship between the "principle of obligation and payment in the same year" and the standards for dividing years for expenditures (Article 2 of the Budget, Settlement of Accounts and Accounts Regulations), refer to Kimura, *Chiho Jichi*, No. 671, p. 16, note (7), as listed in References.

basis, but should expenditures overlapping multiple fiscal years be easily permitted on an accrual basis, various principles resulting from Article 85 would be watered down.

In summary, I consider the principle of independence of the fiscal year as a doctrine under the Constitution, which must be separately examined in terms of financial democracy.

(4) Constitutional basis for the principle of independence of the fiscal year

It is generally said that the principle of independence of the fiscal year (unlike the principle of a single-year budget) is not a doctrine under the Constitution, but a doctrine by virtue of the law. In this regard, the constitutional basis for this principle must be examined again.

As stated above, the principle of independence of the fiscal year is on the assumption of the cash-basis budget and settlement system. While the principle of a single-year budget does not conflict with an accrual-basis budget, the principle of independence of the fiscal year would be extinguished if a complete transition to the accrual-basis budget were permissible under the Constitution.

According to the interpretation of Article 83 of the Constitution explained above, it is not impossible to renounce the “decision and execution model” on a cash basis. However, in my opinion, regarding the budget system, which is the most important method of controlling finance, it is understood that cash-basis accounting, i.e., the “decision and execution model,” is required by virtue of Article 85 of the Constitution and others, so the principle of independence of the fiscal year is also derived from this model.

(5) Special characteristics of local finance

Since it is not necessarily required to apply Article 85 of the Constitution directly to local finance, there is room for allowing moderation of the principle of independence of the fiscal year and the principle of a cash basis for local finance rather than national finance. While I acknowledge its logical possibility, I suppose that the principle applicable to national finance should also apply to local finance at present, in order to achieve consistency between national and local finance (*i.e.*, accounting transparency, or a possibility of consolidation). It is of course possible to separately prepare accrual-basis financial statements on the occasion of settlements of accounts, etc., and it would be appropriate for the Constitution’s philosophy to improve them for local finance, similarly for national finance.

3. Contracts Resulting in Treasury Obligation and Continuous Expenditures

(1) The difference between contracts resulting in Treasury obligation and continuous expenditures

Under the ongoing system, the difference between contracts resulting in Treasury obligation and continuous expenditures is explained as follows. First, while the fiscal year of the occurrence of an obligation is specified in the case of a contract resulting in Treasury obligation, fiscal years are not specified in the case of continuous expenditures. Second, in the case of continuous expenditures, the yearly amount of expenditures is resolved, and in the case of a contract resulting in Treasury obligation, the concerned contract must be resolved regardless of the time of payments, and its expenditures must be resolved in the revenue and expenditure budget for the year in which the payments will take place¹⁵⁾.

(2) Constitutionality of continuous expenditures

Unlike Article 68 of the former constitution, the prevailing Constitution lacks any express provision to allow continuous expenditures. Therefore, their constitutionality has been discussed. The common theory is affirmative in general, due to analogical application of Article 85 of the Constitution which allows contracts resulting in Treasury obligation, or due to actual necessity, or other reasons¹⁶⁾.

15) For example, see Koji Hyodo, “Public Finance and Accounting Law” (Gyosei, 1984), p. 68.

16) Refer, for example, to Miyazawa and Ashibe, p. 720 (footnote 3), and Isao Sato, “Outline of the Constitution of Japan (*Nihonkoku Kenpo Gaisetsu*), Revised 5th Edition” (Gakuyo Shobo, 2001), p. 524.

(3) Constitutional positioning of contracts resulting in Treasury obligation and continuous expenditures (Personal opinion)

In my opinion, the preceding two issues can be summarized as follows:

- (a) It can be understood that limiting a contract resulting in Treasury obligation within a specific fiscal year is only required by virtue of the law, and is not a constitutional requirement. In the Constitution, there is no express provision to the effect that the fiscal year for any obligation should be specified in its resolution. Even if the fiscal year is specified, there is room for allowing a kind of “carry-over” wherein the outstanding balance of an obligation may be brought forward to any subsequent years. Incidentally, carry-over is also allowed in principle under Article 15 of the French law of August 1, 2001. Admittedly, the Diet’s control will be weakened without the said limitation, but it will be possible to keep a certain discipline if the outstanding amounts of obligations are specified in financial statements, or if other proper measures are taken.
- (b) Based on the foregoing interpretation, continuous expenditures may be regarded as a convenient method for contracts resulting in Treasury obligation. Since the form of continuous expenditures is a manner of intensified parliamentary control on contracts resulting in Treasury obligation (the times and amounts of the respective expenditures from an obligation are specified and an approval for them is sought together with a resolution for the concerned contract), such manner is naturally allowed. In addition, the Diet is free to determine expenditures made in any subsequent years for contracts resulting in Treasury obligation, so it is naturally possible to adjust the yearly amount for any continuous expenditures as well.

4. Budget-Making Categories

To implement the performance-based system, it is preferable to make segmented budgets or policy-wise budgets. As many countries make budgets categorized based on purposes or natures of expenditures at present, both Japan and France are preparing to realize similar budget-making.

I do not intend to deny its necessity, but we should not overlook the significance of the prevailing purpose-based categorization for expenditure budgets in that it is substantially budget-making on an organization-wise basis and contributes to intensifying organizational standards, resulting in supplementing insufficiency of the applicable base laws¹⁷⁾. It will be realistic to introduce segmented budgets for some particulars, while maintaining the fundamental budgets on an organization-wise basis.

At any rate, segmented or policy-wise budget-making leads to a radical change of the ongoing budget categories, and it will take a lot of time to establish the legal system for them. Moreover, it is unavoidable to use some artificial techniques in categorizing segments and policies (*e.g.*, allocation of secretariats’ costs). In this regard, one option is to provisionally adopt such a new budget-making system for a trial period, in tandem with the ongoing budget categories. Especially, performance-based internal contracts¹⁸⁾ can be based on segmented budgets or accrual-basis budgets, even under the prevailing laws. It would be realistic to maintain the basic budgets on an organization-wise basis and introduce segmented budgets for specific details.

In terms of autonomous finance control, it is preferable to flexibly set the budget categories. As mentioned below, decentralized finance control can be made at the execution level by means of the system of duty-wise supervisors for action promising expenditure (*cf.* paragraph IV.2), and it is therefore one method to establish budget-making categories corresponding to such supervisors’ scopes of authority.

17)With respect to the concept of organizational standards and base law, refer to Hiroshi Shiono, “Administrative Law I, 3rd Edition”, (Yuhikaku, 2003), p. 61.

18) For the performance-based contracts (*contrat de performance*) in France, refer to Kimura, *Jichi Kenkyu*, Vol. 78, No. 9, p. 71, and Vol. 79, No. 9, p. 154, as listed in References.

III. Issues Concerning Settlements and Accrual-Basis Financial Statements

In connection with settlements of accounts, various issues concerning accrual-basis financial statements (financial statements by double-entry bookkeeping based on corporate accounting practices), as a whole, are reviewed as follows¹⁹⁾.

1. From “Pre-control by Budget” to “Post-control by Settlement”

If we relax the requirement for a “resolution-decision” by the Diet, settlements of accounts become more important as a manner of control other than revenue and expenditure budgets. This means a change from “pre-control by budget” to “post-control by settlement.”²⁰⁾ The Constitution is deemed not to deny such shift of the point of control.

2. Significance of Settlements (Legal Status of Accrual-Basis Financial Statements)

As many administrative bodies and organizations have recently been preparing accrual-basis financial statements based on corporate accounting practices (balance sheets, profit and loss statements, etc.), the legal status of such financial statements must be discussed. This topic is relevant to an issue as to whether the Constitution requires cash-basis settlements or accrual-basis settlements. Regarding the legal status of accrual-basis financial statements, there are three theories as follows:

- (a) Today, such financial statements are prepared as a practical measure to fulfill the nation’s accountability to its people and then disclosed to them.
- (b) According to another theory understanding, such financial statements are deemed to work as “reporting of financial status” pursuant to Article 91 of the Constitution.
- (c) Meanwhile, I assume that accrual-basis financial statements are contained in the “settlement of accounts” as defined in the Constitution.

In my opinion, unlike budgets, settlement of accounts includes not only cash-basis settlement but also accrual-basis settlement. “Settlement of revenues and expenditures” referred to in Article 90 of the Constitution implies only cash-basis statements (revenue and expenditure statements) and the said article merely stipulates the procedures for such settlement, and accrual-basis statements (financial statements based on corporate accounting practices) are additionally required by the Constitution in its philosophy. This interpretation conforms to today’s requirement for shifting emphasis to settlement of accounts. Therefore, there are theoretically two types of financial statements, i.e., cash-basis statements and accrual-basis statements, but both types are capable of being integrated into one systematic type of financial statements, which ultimately seems to be the ideal format.

There are three practical advantages, as stated below, in preparing the integrated statement, including accrual-basis financial statements. First, it serves as reference information for subsequent fiscal years’ budgets; second, it makes clear the deadline for preparation of financial statements; and third, it is possible to avoid redundancy with cash-basis financial statements and keep transparency (in addition, please refer to paragraph VI.1, for its significance in individual finance operations).

Explaining the first and second advantages in detail, Article 41 of the French 2001 Organizational Law explicitly stipulates that deliberations for the budget for two years later cannot be started unless the financial statements including accrual-basis statements have been submitted to the Diet. Regarding the third advantage, there is a likelihood that in the future revenue and expenditure statements will be combined into something that is equivalent to cash flow statements under corporate accounting practices.

19)For the significance of settlement of accounts and the necessity of resolutions, refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 3, p. 44, as listed in References.

20) This is also the case with independent administrative entities. Their finance is regulated by the medium-term plans and annual plans prepared in advance, but they do not have the binding effect of a revenue and expenditure budget, so post-control, based on financial statements prepared for each fiscal year, is rather emphasized.

In view that accrual-basis financial statements are prepared based on cash-basis revenue and expenditure statements at present, it might be difficult to submit them at the same time as revenue and expenditure statements. It will be, however, desirable to prepare them simultaneously with revenue and expenditure statements in the future. This will not be technically difficult, should daily accounting on an accrual basis be followed.

If the foregoing is unavoidably difficult, one possible solution is to set different deadlines for submission of revenue and expenditure statements and accrual-basis statements. This point is relevant to an issue concerning the formality of resolutions of settlement (in this respect, the theories of reporting, of resolutions by both the Lower and Upper Houses, and of resolutions by the Diet are conflicting). In my opinion, a resolution by the Diet is required for cash-basis statements in the light of a function of the Minister's dissolution of responsibility, but reporting (submission) to the Diet is sufficient for accrual-basis statements; considering that both of them are treated in a separate manner, as mentioned above, I do not find any difficulty from the legal viewpoint. Since a resolution inherently entails a submission, the problem will be solved even in the case of integrated financial statements to be prepared as the ultimately ideal form, if resolving such statements as a whole.

In any case, it is understood that a broad legislative discretion will be allowed for the contents of accrual-basis financial statements. I do not suppose that their contents should be fixed in haste at the legislation level, but it is necessary to clarify their status under the Constitution.

3. Who Is Responsible for Preparing Accrual-Basis Financial Statements?

It must be discussed which organizations should prepare financial statements, based on corporate accounting practices. They are prepared by the respective ministries and agencies at present. However, each ministry or agency is entitled to the right of cash-basis expenditures only, and the Ministry of Finance is empowered to control revenues and property to some extent (*cf.* Article 37 of the Public Finance Law, Articles 4 and 10 of the Public Accounting Law, Articles 5 and 7 of the National Property Law, etc.). As the Ministry of Finance possesses information about obligations under public bonds and technical skills for public finance, it should be clearly positioned as a player in preparing financial statements jointly with each ministry or agency.

In the case of a local government, while its head is officially responsible for preparing financial statements, it is often discussed whether each department (its budget and finance section) or the accounting organ (the chief accountant or treasurer) should, in theory, be responsible. Although some say that the accounting organ of the local government should be abolished, I suppose that the principle of separation of a directing organ and an accounting organ should be maintained (as explained in paragraph IV.2 below). From the overall and technical viewpoints also, the accounting organ should, as an organization controlling finance, be one of the players responsible for preparing financial statements. This understanding results from the provision of the prevailing law to the effect that the chief accountant or treasurer is responsible for preparing financial statements (Article 233.3 of the Local Autonomy Law).

4. Purpose of Preparing Accrual-Basis Financial Statements

With respect to the issues mentioned in sections 2 and 3 above, there is a problem as to whether the purpose of preparing financial statements is in management (in France, the concept "management" is used with the English word as it is) to achieve efficient and adequate budgeting, or in accountability to the public. This classification is the same as the classification between management accounting and financial accounting. It is generally found that both of them are described as the purpose of financial statements in the case of public accounting, but it seems that accountability tends to be more emphasized, considering technical restrictions in the management function in the case of budgets²¹.

21) For example, refer to the Public Finance Council's "Basic Ideas for Public Accounting" (June 30, 2003), para.2.(3), and "Financial Statements for New Special Accounts" (June 26, 2003), para. 3.(2).

Schematically speaking, if accountability to the public is emphasized, it is natural to include financial statements in the reports specified in Article 91 of the Constitution, but if the management aspect is emphasized, it is important to include them in the process of budgets and settlements of accounts.

I would like to propose that accrual-basis financial statements be included in the statements of settlements, with a view to placing importance on budget management. Of course, while it may be difficult to achieve efficiency and adequacy of budgets in the ongoing financial statements, I find a great significance in establishing a framework of ideal systems on the assumption that technical problems of financial statements will be improved in the future (this is what was adopted in the French 2001 Organizational Law).

The point of such budget management can be further divided into overall management and segmented management, and the management mentioned in the foregoing paragraphs is the former one, in principle. For the purpose of segmented management, it is effective to legislate the obligation to prepare statements for administrative expenses or other segment information. However, it is not necessarily required to conduct segmented management on a fiscal year basis, so it seems reasonable in a sense to implement such management in a form other than settlement of accounts.

While it is important to fulfill accountability for the burdens to be undertaken by the public in the future, it may be preferable to give priority to fulfillment of accountability for individual financial information (public works, pension, insurances, etc.) because it still remains strongly objectionable to record certain items, such as contracts resulting in Treasury obligation and Treasury's debts for pensions, as liabilities on the balance sheet and it is not necessarily assured that sufficient explanations will be made.

IV. Various Issues Concerning the Accounting System

With respect to the meaning of "accounting" as distinguished from budgets and settlements, many issues concerning financial statements described above are commonly applicable. In this chapter, the topics concerning the concept of accounting and accounting procedures are explained briefly.

1. Definition of Accounting

The concept of accounting is divided into the concept under the law and the substantial (theoretical) concept.

(a) Concept of accounting under the law

The concept of accounting under the law has multiple meanings. In the former constitution and according to the Meiji era's Public Accounting Law, the term "accounting" was used to mean finance in general (including budget-making and settlements). According to the current Public Accounting Law, however, "accounting" is defined mainly as accounting procedures for revenues and expenditures. On the other hand, according to the Board of Audit Law, what can be audited include revenues and expenditures in cash, as well as delivery of real property and movable property (Articles 22 and 23). As such, this concept is equivalent to the meaning of finance in general²².

In the Public Finance Law, the terms for finance are used as accounting units. This is shown in the provision to the effect that accounting is divided into general accounts and special accounts (Article 13).

(b) Substantial concept of accounting

Generally, the substantial concept of accounting is defined as "operations of procedures for incomings/outgoings, records, calculations and classifications of money and other property belonging to

22) As such, two concepts of accounting, i.e., accounting as procedural functions and accounts as accounting units, co-exist under the Japanese law. This situation originates from the translation of the French Decree dated May 31, 1862, created in the Meiji era, in which both "comptabilité" and "compte" were translated into the Japanese term "kaikei". The former French term mainly means "accounting system" and the latter means "accounting units"; the usage of the former term is shown in Article 296 and its subsequent articles of the Decree, and the usage of the latter term in Article 158 and its subsequent articles.

For changes in the concept of accounting in France, refer to Kimura, "The Birth and Current Status of the Public Finance Law in France" to be released in *Nichifutsu Hogaku*, No. 23 (especially, Chapter 1, Section 2.1 and Chapter 2, Section 2.1).

economic entities, in other words, operations of accounting procedures for economic activities.” Based on this, accounting is, in general, divided according to its substantial factors: cash accounts, movable property accounts and real property accounts. Although the nation’s accounting is not different from private accounting in substance, it is pointed out that there are no organic interconnections among these three types in the case of the nation’s accounting, since it is consumption-oriented accounting²³.

(c) Comments

The categorization in the substantial concept is often used mainly for explanation of the legal system. If it is understood that accrual-basis settlements are expected in the Constitution, as I previously explained, it is not necessarily required to adhere to the categorization of accounting in the aforesaid three types even under the legal concept. In this regard, interconnections among these three types are required in terms of double-entry bookkeeping.

In addition, if accrual-basis financial statements are required as the factors of settlement of accounts, the concept of accounting that contains budget and settlement (the concept adopted in the pre-war Public Accounting Law) will be considered reasonable (similar terminology is found in Article 6 of the Ordinance for the Financial System Council). For this point, Chapter 5 (Articles 27 through 31) of the French 2001 Organizational Law serves as reference, and basic standards about accounting are inserted in this law. As these are the factors specified in the prevailing Decree dated December 29, 1962, there arose a constitutional dispute as to whether they are a matter of order, and not a matter of law. The Constitutional Court in France finally made a decision that it is conformable to the constitution, because, although the factors are not originally the objectives of organizational laws, they are “inseparable factors” of organizational laws and closely related to the truth of laws concerning settlement of accounts²⁴.

While I consider it significant to adopt such a broadly-defined (classical) concept of accounting, I would like to use the term “accounting” which excludes the concept of budgets and settlements, according to commonly used terminology.

2. Accounting Procedures

(1) Procedures for expenditures

A problem common to both expenditures and revenues is whether or not to apply the principle of separation of a directing organ and an executing organ (accounting organ). In my view, this principle should basically be maintained in terms of the point of internal control and the application of this principle should be modified, in part, by adopting an advance payment system, etc. It is also necessary to consider authorizing accounting officials, etc., to conduct prior examination of contracts resulting in outgoing payments, in a similar manner as the government’s expenditure officers or certifying officers of action promising expenditure who are so authorized. To streamline operations, one option is to allow entrustment of treasurer’s duties to other municipalities.

Then, from the viewpoint of the performance-based system, one possible solution is to utilize the system of duty-wise supervisors for action promising expenditure, in order to decentralize the authority for such action²⁵.

(2) Procedures for revenues

With respect to revenues, how to treat revenues attributable to the primary duty of each ministry or agency is often mentioned as a problem in connection with the scope of revenues from stamp duty.

Under the French law, accounting officials belonging to the Ministry of Finance (except for officials responsible

23) For this concept, see Kiyoshi Hosomizo, “Detailed Explanations of the Latest Public Accounting Law, Revised and Enlarged Edition” (Okura Zaimu Kyokai, 2002), p. 1, and Hyodo, p. 123 (footnote 15). For the pre-war theory, see Shiro Kiyomiya, “The Public Accounting Law” (Nippon-Hyoron-Sha, 1939), p. 2.

24) C.C. 25 juillet 2001, DC2001-448, considérant 57. If explained under the Japanese law, this leads to the problem if all the provisions of the Public Accounting Law must be prescribed in the form of law, or not.

25) Refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 11, p. 80, as listed in References.

for advance payments) are responsible for integrated management of outgoing and incoming payments in cash, so there is no concept of revenues attributable to the primary duty of each ministry or agency (*cf.* Article 16 of the Decree dated December 29, 1962). In Japan, this point was amended to be incorporated in the 1889 Public Accounting Law where accounting officials of each ministry or agency would take care of revenues attributable to the primary duty of the respective ministry or agency, although the 1889 Public Accounting Law was prepared by making reference to the French accounting system (Article 84 and subsequent articles of the 1889 Public Accounting Regulations, Article 38 and subsequent articles of the current Public Accounting Law). However, as the French system is followed with respect to revenues from stamp duty, the Ministry of Finance is in charge of revenues from stamp duty relating to other ministries' and agencies' duty.

In preparing financial statements for the respective ministries and agencies, it is a point in dispute whether or not revenues attributable to the primary duty of the respective ministries and agencies will be recognized as their own earnings. From the viewpoint of the legal system, however, whether or not to expand the scope of revenues attributable to the primary duty of the respective ministries and agencies becomes the point in dispute.

The French system is attractive in that separation of the directing organ and the executing organ is fully performed, which enables clarification of the procedural control on revenues and expenditures, and which can clarify where the responsibility lies. However, the French system has a harmful effect in the respect of the decentralization of the accounting authority. It is therefore necessary to harmonize both French and Japanese systems and care must be taken to amend the ongoing Japanese system. With respect to the classical method of stamp duty revenues, it should probably be denied from the viewpoint of the performance-based system, since this method makes unclear their relationship with corresponding expenses.

On the other hand, the principle of standardized revenues and expenditures (Article 2 of the Public Accounting Law) must be maintained and it should not be allowed that each ministry or agency is authorized to make expenditures at its own discretion with regard to the revenues attributable to its primary duty. Even though each ministry or agency may be authorized to autonomously control such revenues in the future, such control should be based on performance-based contracts, etc., with the Budget Bureau of the Ministry of Finance, maintaining the above-mentioned principle.

(3) Contracting procedures

In tandem with the decentralization of the authority of expenditures, there is room for reconsideration regarding the concentration of the contracting authority to contract officers (action-promising-expenditure officers, in principle)²⁶.

Under the current law, contracting procedures are based on open competitive bidding in principle, and further based on the assumption of price competition; but the comprehensive evaluation method may be allowed in some cases (Article 91.2 of the Budget, Settlement of Accounts and Accounts Regulations, and Article 167-10-2.1 of the Autonomy Ordinance)²⁷. If qualitative aspects of the administration are becoming more important under the performance-based system in the future, it will be necessary to reconsider the adequacy of open competitive bidding and place importance on factors other than pricing²⁸.

26) Refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 11, p. 87, as listed in References.

27) For the comprehensive evaluation method, see Usui, "Explanations of Main Points of Laws for Local Government Finance, Revised Edition" (Gakuyo Shobo, 1999), p. 235.

28) For this point, it is worth referring to the New Code of Contract Laws for the Government and Public Offices enacted on March 7, 2001 in France (Kimura, "Introduction of Legislation: Enactment of the New Code of Contract Laws for the Government and Public Offices" to be released in *Nichifutsu Hogaku*, No. 23).

V. Various Issues Concerning Accounting Audits

In this chapter, I would like to reorganize the legal status and functions of the Board of Audit from the present-day viewpoint²⁹⁾ and refer to some traditional issues concerning accounting audits.

1. Legal status of the Board of Audit

With respect to the legal status of the Board of Audit, there is a conflict in theories, especially about whether or not the Board is an organization supporting the Diet (auxiliary organ to Diet)³⁰⁾. I am in favor of the theory of an organization supporting the Diet due to the following reason.

In order to satisfy the intent of “control of the Diet by information” under Article 83 of the Constitution, it is important to control Diet-related information through the Board of Audit. In particular, if the point of control is shifted from budgets to settlement of accounts, the requirement of post-evaluation by an organization other than the Diet will be enhanced. Primarily, self-control by the Diet should not be overlooked, but the Board of Audit’s involvement must be broadened, considering its skills in handling public finance matters. Indeed, positioning of the Board of Audit as a supporting organization for the Diet is contrary to the history of the law or the wording of the relevant provisions (Article 90 of the current Constitution, which is based on Article 72 of the former constitution, to the effect that audit reports must be submitted to the Cabinet, the existence of Article 1 of the Board of Audit Law, etc.), but I suppose such positioning would be acceptable as a modern interpretation, in the light of a trend that the Diet’s involvement with the Board of Audit (*cf.* sections I.2 above and V.3.(a) below) has been expanding since WWII.

Nevertheless, it is merely an ideal, in most cases, that the Board of Audit is a supporting organization for the Diet. Moreover, in view of the Board of Audit’s independence, the Diet must be prohibited from being involved with audit planning made by the Board. In addition to acknowledging the theory of an organization supporting the Diet, it is necessary to establish the status as a judicial organ (*cf.* section V.3 below).

2. Relationship between Accounting Audits and Policy Evaluations

(1) The function of policy evaluation by the Board of Audit

Some opinions are negative in seeking the Board of Audit’s role in policy evaluation³¹⁾. However, in order to enhance the information-providing function (based on the functions of collecting, analyzing and evaluating information) as a supporting organ for the Diet, I view the Board’s role in policy evaluation positively. In addition, under the law, accounting audits adopt the factors of “3E,” *i.e.*, “economy,” “efficiency” and “effectiveness,” as well as the traditional standpoints of “accuracy” and “legitimacy,” by amendments to the Board of Audit Law in 1997 (Article 20.3). Therefore, the scope of the Board of Audit’s function of policy evaluation is relevant not only to constitutional theories, but also to interpretative theories of the Board of Audit Law.

To supplement the reasoning for my opinion, I would like to review some difficulties in the Board of Audit’s policy evaluation.

(a) Legal difficulties

The first problem is the manner of descriptions in the Constitution. The French Constitution clearly stipulates that the Board of Audit is responsible for assisting the Diet and the Government (Article 47) and the

29) For the legal status of the Board of Audit and policy evaluation, refer in particular to Kimura, *Jichi Kenkyu*, Vol. 79, No. 3, p. 51, as listed in References. For the status of theories in this regard in France, further refer to Kimura, “Academic Outlook” to be included in *The Journal of the Association Political Social Sciences*, Vol. 116, Nos. 11 and 12.

30) For the status of these theories, refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 3, p. 59, note (76), as listed in References. Recently, Professor Usui has expressed doubt about the theory of an organization supporting the Diet (see Usui, *Jichi Kenkyu*, Vol. 79, No. 3, p. 19 (footnote 13)).

31) While it is a relative categorization, I mention the following theses which express opposite views on authorizing the Board of Audit to make policy evaluation: for a negative view, see Usui, *Jichi Kenkyu*, Vol. 79, No. 3, p. 17 (footnote 13), and Sakurai, p. 197 (footnote 6); for a positive view, see Hisahiro Ishimori, “Study of the Board of Audit of Japan” (Yushindo, 1996), p. 233, and Kai, p. 172 (footnote 10).

case law of the Constitutional Court shows that assisting the Diet takes precedence over assisting the Government³²⁾; therefore, functions other than accounting audits can be easily acknowledged. In Japan, however, lack of such a stipulation in the Constitution is problematic. Furthermore, if the Board of Audit, which is an organ independent from the Cabinet, is given the administrative competence for policy evaluation, in addition to the authority of accounting audits expressly specified in the Constitution (Article 90), it may cause conflict with Article 65 of the Constitution. However, the concept of the administrative power defined in Article 65 should be interpreted as “executive power,” as so indicated in the original English version of the Constitution, and it can be understood that acknowledging the Board of Audit’s power will not be disputable, taking into consideration that the existence of independent administrative committees is supposed to be allowed, if controlled by the Diet, even without any express authorization under the Constitution³³⁾. Moreover, if the Board of Audit is regarded as a supporting organ for the Diet, it seems that no theoretical difficulty will occur.

(b) Political difficulties

If the Board of Audit’s policy evaluation becomes more operative, there may arise a concern about increasing political interference by the Diet. Particularly, it appears that such concern would increase should the Board of Audit be a supporting organ for the Diet. In France, however, the Board of Audit positioned as a supporting organ for the Diet is not so much influenced by political power; rather, regional boards of audit without such positioning are susceptible to political restrictions. This will be instructive for us as to the positioning of the Board of Audit.

With respect to local finance, I assume that needs for regional boards of audit will increase, because we cannot expect too much in policy evaluation by external independent auditors, and further, because political influence should be avoided if there is a full-scale movement to adopt project budget management on a multiple-year basis for a period exceeding the audit contract term.

Based on the foregoing, I assume that it will be necessary to expand the policy evaluation function of the Board of Audit and reinforce human resource both for national and local finance.

(2) Significance of segregation of accounting audits and policy evaluation

Even if policy evaluation is contained in accounting audits, for which the Board of Audit is competent, it is possible to distinguish accounting audits in the traditional meaning of legality examinations (narrow definition) from policy evaluation, for explanatory convenience³⁴⁾.

The demarcation of accounting audits and policy evaluation is not so clear from the beginning, and both of them are actually conducted simultaneously in many cases. It is also understood that Article 20 of the Board of Audit Law is based on such circumstances. According to the interpretation of this article, the factors in the traditional, narrowly-defined accounting audit (accuracy and legality) are compulsory, while the policy evaluation factors (economy, efficiency and effectiveness) are discretionary. In the event any evident defect is found in terms of economic efficiency, etc., it is interpreted that the Board of Audit’s intervention will be compulsory pursuant to the “theory of reduction of discretion” under administrative laws³⁵⁾.

32) C.C. 25 juillet 2001, DC2001-448, considérant 107.

33) As the typical descriptions of this statement, see Nobuyoshi Ashibe, supplemented and revised by Kazuyuki Takahashi, “The Constitution (Kenpo), 3rd Edition” (Iwanami Shoten, 2002), p. 295.

34) For French terminology, see Kimura, *Chiba University Hogaku Ronshu*, Vol. 16, No. 4, p. 21, as listed in References.

35) This categorization is considered to be basically applicable to auditing by accounting auditors in independent administrative entities. For this issue, refer to the Public Finance System Council’s “Report on Audits by Accounting Auditors for Independent Administrative Entities” (July 4, 2003), Chapter 1, Section 6.

3. Issues Concerning Liability

In the field of the traditional accounting audit, it is necessary to discuss examination and re-examination of the Board of Audit (Article 32.2 of the Board of Audit Law, Article 4 of the Law concerning Liabilities of Budget Execution Personnel, and Article 31 of the National Commodities Control Law) in respect of its protestability (possibility of cancellation proceedings) and the necessity of adopting the principle of substantial evidence.

(a) Protestability of examination

According to an influential theory, examination and re-examination of the Board of Audit cannot be brought into a lawsuit for cancellation³⁶, but the case law supports its protestability (Tokyo District Court, November 28, 1984, *Hanrei Jiho*, Vol. 1141, page 70).

The negative theory is based on the system of compensation order before examination (Article 43 of the Public Accounting Law, Article 4 of the Law concerning Liabilities of Budget Execution Personnel and Article 33 of the National Commodities Control Law) and further based on the fact that it is the administrative organ, which has issued the concerned order, to be directly bound by the examination.

I would like to discuss this issue again at another time, but it is necessary to make logical explanations about the authority held at multiple levels by the Board of Audit, administrative organs, courts and the Diet. Concerning distribution of the authority between the Board of Audit and administrative organs, in my opinion, the Board of Audit has a principal and exclusive right of recognizing the legality of accounting, and the Board of Audit, the courts, the ministers and the Diet share the right of recognizing liabilities. Among them, the authority of the ministers and the Diet symbolizes the importance of political control under the Public Finance Law. In particular, a system for reduction of or exemption from liabilities by the Diet (Article 32.4 of the Board of Audit Laws and Article 7 of the Law concerning Liabilities of Budget Execution Personnel, and in addition, for local assemblies, Article 243-2.8 of the Local Autonomy Law), founded after WWII, will be initiated by political judgment, so this system can be understood separately from judicial operations.

In the wording of the applicable laws, the Board of Audit's role is "examination of facts," concentrating on legality of accounting. Furthermore, since the laws are read in the manner that the Board of Audit's judgment regarding liabilities is limited to whether or not there has been illegality (*cf.* Article 32.1 of the Board of Audit Law, etc.), the Board of Audit's role regarding the factors in liabilities such as willful misconduct, negligence or occurrence of damage is just giving a chance to start the case. In a substantial theory also, this interpretation will make it possible to utilize the Board of Audit's technical skills related to accounting legality (a factor not generally found in claims for damages in civil cases heard by a judge)³⁷.

(b) Applicability of substantial evidence rule

Taking into consideration that the applicable laws stipulate careful procedures for examination or re-examination of the Board of Audit, such as auditors' meetings under a council system (Articles 2 and 11 of the Board of Audit Law, Articles 5.2 and 5.3 of the Law concerning Liabilities of Budget Execution Personnel, etc.), the principle of substantial evidences will apply to accounting legality, which is an assumption of individual

36) For a negative opinion about protestability, see Shinji Tanaka and Yasumori Kato, "Explanations of the Administrative Complaint Investigation Law, 5th Edition" (Nippon-Hyoron-Sha, 1971), p. 49. For a positive opinion, see Yuzo Nakanishi, "Liability of Accounting Officials", a part of "The Structure of Modern Administrative Law" edited by Ichiro Ogawa et al., Vol. 10, p. 341 (footnote 4), although it states, "We cannot say that there is no problem in view of legislation policy (p. 342)". In addition, Hiroshi Shiono says that protestability is "questionable" in "Administrative Law III, 2nd Edition" (Yuhikaku, 2001), p. 265.

37) As is well known, the term "hanketsu," ("judicial decision") was used before WWII instead of "kentei," ("examination") in accordance with the Board of Audit of France, one of the countries from which we adopted our accounting system (Article 26 of the 1889 Public Accounting Law and Article 35.2 of the 1921 Public Accounting Law).

For an opinion which acknowledges the nature of a judicial function in examination of the Board of Audit under the current Constitution, refer to "The Constitution of Japan, 2 of 2" (Yuhikaku, 1954) by the Jurisprudence Association (Hogaku Kyokai), p. 1344. Shozaburo Sugimura also says, "Insofar as an examination of liabilities is concerned, the Board of Audit has a function equivalent to a judicial organ, a part of its own authority", in "Public Finance Law, 2nd Edition" (Yuhikaku, 1982), p. 147.

liabilities, even without any express provision under the laws³⁸). This can be derived from the assumption that the Board of Audit has a principal right of recognizing legality of accounting in the examination described in section (a) above.

As explained above, I assume that the (quasi-)judicial-organ-like characteristics of the Board of Audit should be emphasized in accounting audit, and this is considered to ensure independence of the Board of Audit in the end.

(c) Protestability of compensation order

With respect to a compensation order issued by an administrative organ (Article 32-3 of the Board of Audit Law), the common theory denies its protestability³⁹). This is because a compensation order is nothing other than the exercise of the right of a claim for damage that has objectively come into effect and no specific stipulation is provided for administrative proceeding. In my opinion, however, protestability of a compensation order can be acknowledged, since the applicable laws provide the procedures for prompt recognition of liabilities (unlike normal civil liabilities) and a prompt solution should also be sought by means of a cancellation proceeding.

(d) Liability of officials other than budget and accounting officials

It has been discussed in theory for a long time whether or not an administrative organ (the national or local government) can claim for damage against officials other than budget or accounting officials⁴⁰). Since the Supreme Court judges that the provisions under the civil laws are applicable to the head of a local government (Supreme Court, February 27, 1986, *Minshu*, Vol. 40-1, page 88), it is considered that the traditional principle of non-liability for state activities of ordinary officials has been amended under the case law. However, in order to keep balance with the requirements for liabilities of budget and accounting officials, and based on application of Article 1.2 of the State Tort Liability Law, I would like to support an opinion requiring gross negligence or willful misconduct⁴¹).

With respect to the aforesaid liabilities lacking any express provision of the applicable laws, officials conducting unauthorized management of public money or property must be treated in accordance with the same procedures as applicable to budget and accounting officials by a legislation theory (or by a interpretative theory), comparable to the French legal theory concerning a *de facto* accountant (*comptable de fait*), and the Board of Audit's involvement must be acknowledged⁴²).

4. Taxpayers' Suits

According to the recent discussions on reform of administrative suits, a proposal for introducing a system equivalent to citizens' lawsuits for local finance at the national level has been raised; in this regard, a submission of claims to the Board of Audit is intended, instead of an audit request in the case of local finance.

However, if the Board of Audit is authorized to substantially act as a (quasi-)judicial organ, as explained above, it is almost insignificant to seek a court decision based on and fully in place of the Board of Audit's decision. Taxpayers' interest in this case will be found, not in individual liabilities of officials who have committed a breach, but primarily in confirmation of illegality in financing or accounting activities⁴³). Therefore, if recognition of

38) For an opinion which acknowledges the principle of substantial evidence even without any provision in law, refer to Hajime Kaneko, "Judicial Review of Administrative Law Judge's Decision", a part of "Essays in Commemoration of the 60th Birthday of Judge Iwamatsu" (Yuhikaku, 1956), p. 457; Ichiro Ogawa, "An Issue Concerning Judicial Examinations," a part of "Theories of Administrative Lawsuits" by Ogawa (Yuhikaku, 1986), p. 562; and Naohiko Harada, "Judicial Review of Administrative Law Judge's Decision," a part of "Benefits of Lawsuits" by Harada (Koubundo, 1973), p. 195. In addition, see Hiroshi Shiono, "Administrative Law II, 2nd Edition" (Yuhikaku, 1994), p. 41.

39) For a negative opinion about protestability of compensation orders, see Shiono, "Administrative Law III," p. 265 (footnote 36). It seems that Tanaka and Kato (footnote 36, p. 49) also expresses a similar opinion.

40) For a negative opinion about liability of general officials to the Treasury, see Minobe, p. 733 (footnote 11) and Sugimura, p. 289 (footnote 37). For a positive opinion, see Jiro Tanaka, "The New Edition Administrative Law, 2 of 3, Revised 2nd Edition" (Koubundo, 1976), p. 281; and Shiono, "Administrative Law III," p. 265 (footnote 36).

41) See Tanaka, p. 281 (footnote 40); Shiono, "Administrative Law III," p. 265 (footnote 36); and Nakanishi, p. 324 (footnote 36).

42) Refer to Kimura, *Jichi Kenkyu*, Vol. 79, No. 11, pages 84 and 97, as listed in References.

43) It is necessary to consider establishing a balance with the consequence of the amendments to the Local Autonomy Law in 2003, by which citizens are precluded from direct claim for compensation.

accounting illegality falls under the scope of the Board of Audit's exclusive authority in principle, according to my opinion, it would not be so beneficial to bring it before judicial proceedings. In addition, if the Board of Audit is positioned as a supporting organ for the Diet, it is questionable to incorporate the Board of Audit in the pre-judicial procedures. From the viewpoint of the performance-based system, a priority should be given, for the present, to enhancement of examinations of economy, efficiency and effectiveness that are beyond the legality control, rather than to the strengthening of the public's initiative in respect to the traditional legality control and reinforcement of the Board of Audit's corresponding function.

Needless to say, the scope of taxpayers' suits is a matter to be determined by political judgment and, in the case of the nation-level taxpayers' suits, the scope of payers and beneficiaries covers an extensive range; therefore, we must treat this issue carefully⁴⁴). Under the present condition, therefore, it seems appropriate to utilize the "request for examination" system under Article 35 of the Board of Audit Law.

VI. Other Relevant Issues

As it is likely that subsidies and staff number management will be more important under the performance-based system, I would like to review these issues⁴⁵), as well as those concerning management of financial property (out of public service) in this last chapter. Please understand that this thesis is not intended to exhaustively review all the issues.

1. Necessity of a Legal Basis for Subsidies

The traditional theory and actual operations are based on the theory of partial reservation of law, in which an individual legal basis is not required and a resolution of budget is sufficient. The Supreme Court's decision acknowledges that a general provision of Article 232-2 of the Local Autonomy Law is a sole fundamental standard for subsidies issued by local governments and seems to take a position that no other specific laws or provisions are required (Supreme Court, August 29, 1978, *Hanrei Jiho*, Vol. 906, page 31).

On the other hand, from the standpoint of the theory of complete reservation, or from the standpoint of the theory of partial reservation as supported by application of financial democracy specified in Article 83 of the Constitution, there is an influential theory to the effect that subsidies require the legal basis by virtue of the specific laws⁴⁶).

I also agree that this influential theory (the theory requiring legal basis) is persuasive, considering a balance with reduction of or exemption from taxes which has the same function as subsidies, since such reduction or exemption must be based on the law in terms of constitutionality. However, if the other theory not necessitating the legal basis is adopted, I still consider it possible to satisfy the requirement of financial democracy by enhancing procedural control on subsidies⁴⁷).

Its first method is to enrich examinations by councils both inside and outside of the assembly. Some local governments have recently established screening organs including outside members for publicly available subsidies, etc. If the examination results by this kind of organs are submitted to the assembly, it may work as an alternative control, instead of a resolution.

44) Kimura, "The Theory of Tax with an Exchangeable Value as a Taxation Basis (4)", *Jichi Kenkyu* (2000), Vol. 76, No. 7, p. 84.

45) For subsidies and staff number management, refer to my article now being released in serial fashion from *Jichi Kenkyu*, Vol. 79, No. 9 (previously published sections are found in Vol. 79, No. 9, p. 154), and this thesis mentions a core direction only. For French administration by subsidies, refer to Kimura, "Decentralization of the Management of Port Authorities in France" (*Kowan*, Sep. 2003), p. 46.

46) For a typical supportive opinion which asserts that subsidies are justified without legislation, see Jiro Tanaka, "General Theory of Administrative Law (*Gyosei-ho Soron*)" (Yuhikaku, 1957), p. 132. For an opinion that subsidies necessitate legislation, see Hiroshi Shiono, "Legal Issues in Administration by Subsidies", a part of "Administrative Process and Its Control" by Shiono (Yuhikaku, 1989), p. 35; Mitsuaki Usui, "Subsidies", a part of "The Structure of Modern Administrative Law", Vol. 10, p. 225 (footnote 4); Toshiro Fuke, "Treasury Investment and Loan", a part of "The Structure of Modern Administrative Law", p. 221; and Usui, "Law for Local Government Finance", p. 249 (footnote 27).

47) Usui says that if the contents of budgets to be resolved are expanded, budgets may possibly replace the law, in his thesis, "The Structure of Modern Administrative Law", p. 232 (footnote 4).

The second method is to disclose subsidies in financial statements. At present, budget statements at municipal levels specify the individual amounts of subsidies, while those of the nation specify a lump sum amount only. To supplement this, accessory schedules attached to the financial statements are effective. From fiscal 2002's settlement of accounts, it is required to specify the breakdowns of major subsidies in the financial statements (financial documents) in special accounting, and this arrangement is likely to be expanded to financial statements in general accounting and to those for the respective ministries and agencies. It is expected that such improvement in financial statements will replace the applicable laws (needless to say, it is desirable to specify all subsidies in principle). In this connection also, it is hoped that financial statements will be included in statements of accounts and that they are submitted to the Diet (*cf.* section III.2 above).

2. Contract for Grant of Subsidies

There is a dispute as to whether or not it is possible to grant subsidies based on a subsidy-granting contract instead of a subsidy-granting decision under the Act for Normalization of Grants (Article 6)⁴⁸. The negative theory seems proper, but apart from this dispute, it is useful to conclude a subsidy-granting contract in actual operations. It is significant in that: first, policy evaluation for the project for which the subsidy will be used is obligated under the contract; second, budget management on a multiple-year basis becomes virtually possible; and third, the expiration is specified for the subsidy, resulting in avoidance of occurrence of vested rights (although the renewal of the contract is possible, the applicant is supposed to bear a burden of proof as to the necessity of the subsidy upon renewal). The above-mentioned contract is just a practical one (a gentleman's agreement), but in the event of breach by the national government, the prospective beneficiary is entitled to a claim for damage and, thus, the minimum enforceability is ensured.

In order to recognize such a subsidy-granting contract as a legal vehicle, one idea is to form the subsidy as a contract resulting in Treasury obligation. In this case, of course, a subsidy-granting decision is separately necessary.

3. Staff Number Management

In Japan, the number of staff of each administrative organ is prescribed strictly in quantity based on the Personnel Strength Law of the National Administrative Organs (the "Total Staff Number Law").

In preparing accrual-basis financial statements, however, it is necessary to allocate personnel expenses or retirement allowances among organizations. Under present circumstances, mechanical allocation is inevitable in accordance with the Total Staff Number Law, causing a result contrary to actual situations (for example, no personnel expenses are counted for certain special accounts such as special accounts for distribution of transfer taxes and those for urban development funding).

Other countries do not have any law equivalent to the Total Staff Number Law, and are only bound by restrictions by budget (the number approved in the budget) in most cases. In France, an increase or decrease in the number of officials was strictly controlled by the Diet pursuant to the former Ordinance dated January 2, 1959, but it is now controlled by the number approved in the budget pursuant to the Organizational Law dated August 1, 2001. In other words, it is a shift from control by flow to control by stock⁴⁹.

Under the performance-based administrative system, we should stop a strict number control based on the Total Staff Number Law and establish flexible operations for each administrative organ. As a legal controlling method, it is understood under the Constitution (the first half of Article 85) that employment of officials requires a resolution

48) For a negative opinion, see Shiono, "Administrative Law I", p. 171 (footnote 17), and Mitsuo Kobayakawa, "Administrative Law, 1 of 2" (Koubundo, 1999), p. 261. For a positive opinion, see Noboru Ishii, "Theories and Actual Operations of Administrative Contracts" (Koubundo, 1987), p. 130.

49) In France, digitized administration is being advanced, conducted in parallel with the reform of staff number management, even though these two matters are not mutually relevant under the French system. Refer to Kimura, "The Trend of Improvement of Administrative Operations in France", *Kikan Gyosei Kanri Kenkyu* (Dec. 2003), No. 104, p. 27.

by the Diet, since it is a contract resulting in obligations and future expenditures, but control by the Total Staff Number Law is not necessarily required. It seems sufficient to restrict the total number of officials based on the number approved in the budget and deny carry-over of expenditures for personnel expenses, in principle. This method is further expected to enable practical management of staff numbers and facilitate preparation of financial statements.

4. Management of Financial Property

A problem similar to staff number management arises with respect to attribution of financial property. While financial property is managed by the Ministry of Finance (“MOF”) as a whole (Article 6 of the National Property Law), in some cases this does not fit in with the actual condition.

For instance, the investment in capital is subject to MOF’s management as financial property (Article 2.1(6) of the National Property Law), and not to the ministry or agency that has actually established a quasi-governmental corporation, etc. As a result, in preparing organ-related financial statements of each ministry or agency, the amount of investments in quasi-governmental corporations, etc., must be allocated again to the founder ministry or agency. Moreover, when provisionally using administrative property as financial property (for the purpose of loans to private enterprises, etc.), transfer of property is deemed to be an obstacle.

In addition, creation of Article 11-2 of the Private Finance Initiative Law, as amended in 2001, revealed the latter problem mentioned above. In this case, the administrative property should be managed as financial property provisionally; but to keep it as administrative property, it results in the treatment of such administrative property as if it were financial property under the law. If we return to the principle and forgo the application of the said article, we can nominally consider that property as financial property; however, as the concerned organ (the organ using it as administrative property) must be authorized to manage the property to some extent, this arrangement will restrict the scope of application of this article which forces an irregular management of administrative property.

It is not my intention to deny the authority of MOF for the entire financial property, since MOF has technical skills and comprehensive judgment for public finance, so I suppose that the fundamental intention of Article 6 of the National Property Law should be maintained; at the same time, it is also necessary to consider authorizing each ministry or agency to substantially and continuously manage the concerned property in the manner of concluding a contract or agreement with MOF, even under the management of MOF (this kind of contract can be combined with the budget or the subsidy contract as explained above).

As described in the foregoing, substantial distribution of the authority for financial property will not only facilitate preparation of financial statements, but also enhance liquidity between administrative property and financial property, contributing to efficient and flexible operations of property. As a legislation issue also, it will become a task to expand the scope of application of Article 8 of the National Property Law and exceptions for Articles 4 and 5 of its Enforcement Ordinance.

Conclusion

With the accumulation of study results by “law and economics” in the field of private law, the necessity of interchange between tax law and economics or science of finance, etc., are asserted in the field of public law. For the future, it will be necessary to pursue this interchange between public finance law, which is a relatively new area of public law, and the sciences of public finance and accounting. While I am still working toward achieving the type of results that could meet the aforementioned necessity, at this time I would like to express my gratitude to the accounting experts for many instructions they have given to date in the meetings for the Public Finance System Council of the Ministry of Finance, the various study groups of the Ministry of Public Management, Home Affairs, Posts and Telecommunications, and others. No one can deny the current advancement in sciences of finance and accounting in the field of budgets and accounts, and I would highly appreciate receiving opinions or comments from the experts in such areas on this thesis, which is designed to provide analysis mainly from the legal viewpoint.

To the editors of this journal, I would like to express my sincere apology for my several postponements, even though I had received a request for writing this thesis very early on, and thank them for their considerable patience. Clearly realizing the impact of the principle of independence of the fiscal year on our daily studies and writings, I feel it is ironic to affirm the constitutionality of such a principle. This thesis is also an outgrowth of this principle.

While such uncomfortable foothold in respect of the academic area or the timing is nothing more than a mere excuse, I wish this thesis would be a basis for future legal discussions, bringing this thesis to the end.

(References)

More than half of the issues mentioned in this thesis duplicate what has been said in some of my past theses (listed below). For such issues, this thesis describes conclusions in principle only. Therefore, with respect to the details or literature concerning my personal opinions stated above, I request referring to the relevant parts of the theses listed below.

(1) For review of discussions on budgets and accounting

Takumaro Kimura, "Tentative Theory for Construction of Performance-Based Administrative and Financial System (1), (2) and (3)(to be continued) – Multiple-Year Basis Budgets, Subsidies and Staff Number Management", *Jichi Kenkyu* (2003-2004), Vol. 79, No. 9, p. 138, Vol. 79, No. 11, p. 79, and Vol. 80, No. 9, p. 80; "Principle of Single-Year Budgets and Principle of the Independence of the Fiscal Year", *Chiho Jichi*, No. 671 (Oct. 2003), p. 2.; "Modern Change in Control of Public Finances (1 & 2) – Preliminary Thesis for Study Focused on Functions of the Diet and the Board of Audit," *Jichi Kenkyu* (2003), Vol. 79, No. 2, p. 91, and Vol. 79, No. 3, p. 44; "Review of Manner of Expenditures in Public Accounting – Aiming at an Introduction of Government Credit Cards", *Chiba University Hogaku Ronshu* (2002), Vol. 17, No. 2, p. 1; and "The 2001 Amendment of the 'Financial Constitution' in France", *Jichi Kenkyu* (2002), Vol. 78, No. 9, p. 57.

(2) For review of discussions on the Board of Audit of Japan and policy evaluation

Takumaro Kimura, "Policy Evaluation by Accounts Auditing Organs and Its Political Obstacles – Reform of French Local Accounting Organs", a part of "Autonomous Administration and Lawsuits" edited by Tadaaki Uchiyama et al. (Gyosei, 2003), p. 495; "The Board of Audit of France and Policy Evaluation," *Chiba University Hogaku Ronshu* (2002), Vol. 16, No. 4, p. 1; "Policy Evaluation in France – Focusing on Evaluation of Harbor Projects," *Kikan Gyosei Kanri Kenkyu* (2001), No. 95, p. 13; and Jean Louis Gousseau, "Policy Evaluation in France" translated by Takumaro Kimura, *Jichi Kenkyu*, Vol. 80, No. 2, p. 37.

(3) For review of fundamental theories underlying the issues of (1) and (2)

Takumaro Kimura, "The Evolution of Theories of Public Finance Law and Its Environments" (Yuhikaku, 2004); Les finances publiques dans l'œuvres de Maurice Hauriou, *Revue française de finances publiques*, No. 70, 2000, p. 171.