
Issues of Incorporated Administrative Agencies Auditing Standards: Comparing with Global Standards*

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I Introduction

Incorporated Administrative Agencies (IAAs) were established in April 2001 in Japan, in order to implement subjects that may otherwise not be carried out if entrusted to private entities, which are within operations and projects that must be implemented from the viewpoint of the public necessity and need not be implemented by the government itself. Although the accounting of IAAs is to be essentially based on corporate accounting principles¹⁾, Accounting Standards for IAAs and their relevant notes were formed, adding modifications to the corporate accounting principles. This is because IAAs have different characteristics from private enterprises assumed in the corporate accounting. IAAs prepare their financial statements according to Accounting Standards for IAAs, and submit them to the competent ministers with the business reports and statement of accounts. Moreover, the IAA that reaches specific conditions²⁾ shall undergo an audit of its financial statements, business reports (portion regarding accounting) and statement of accounts, not only by an inspector but also by an accounting auditor³⁾ (Table 1 indicates the implementation situations of audits by an accounting auditor). The audit by an accounting auditor is being carried out in accordance with Auditing Standards for Incorporated Administrative Agencies by Accounting Auditors (hereinafter, “Auditing Standards for IAAs”) formed in March 2001 and generally accepted auditing standards in Japan. The preparation of Auditing Standards for IAAs in addition to the auditing standards applied to private enterprises was ascribable to the necessity to consider the nature of IAAs as public bodies.

* In preparations for this paper, I conducted an on-site investigation in Britain in September 2007, in which I had an interview with National Audit Office (NAO) and accepted some data.

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¹⁾ Article 37 of the Act on General Rules for IAAs

²⁾ IAAs with capital less than 10 billion yen and liabilities less than 20 billion yen are excluded (Article 2, Government Ordinance on Common Matters on Organizations, Operations and Managements for IAAs).

³⁾ Article 39 of the Act on General Rules for IAAs

Table 1: Implementation situations of the audits of financial statements of FY2005 by accounting auditors

Competent ministry	Incorporated Administrative Agencies (IAAs)	Date of submission of audit report	Accounting auditor
Cabinet Office	Northern Territories Issue Association	June 16, 2006	KPMG AZSA & Co.
Ministry of Internal Affairs and Communications	National Institute of Information and Communications Technology	June 6, 2006	KPMG AZSA & Co.
	National Research Institute of Fire and Disaster	June 14, 2006	Toyo Horwath
	National Statistics Center	June 8, 2006	KPMG AZSA & Co.
	The Public Foundation for Peace and Consolation	June 20, 2006	Ernst & Young ShinNihon LLC
Ministry of Foreign Affairs	Japan International Cooperation Agency	June 15, 2006	Ernst & Young ShinNihon LLC
	Japan Foundation	June 19, 2006	Ernst & Young ShinNihon LLC
Ministry of Finance	Japan Mint	June 20, 2006	Deloitte Touche Tohmatsu
	National Printing Bureau	June 12, 2006	KPMG AZSA & Co.
	Commemorative Organization for the Japan World Exposition '70	June 13, 2006	Deloitte Touche Tohmatsu
Ministry of Education, Culture, Sports, Science and Technology	National Center for University Entrance Examinations	June 13, 2006	KPMG AZSA & Co.
	National Olympics Memorial Youth Center	May 29, 2006	KPMG AZSA & Co.
	National Youth Houses	May 29, 2006	KPMG AZSA & Co.
	National Children's Center	May 29, 2006	KPMG AZSA & Co.
	National Institute for Japanese Language	June 28, 2006	Chuo Aoyama Pricewaterhouse Coopers
	National Museum of Nature and Science	June 12, 2006	Ernst & Young ShinNihon LLC
	National Institute for Materials Science	June 8, 2006	Chuo Aoyama Pricewaterhouse Coopers
	National Research Institute for Earth Science and Disaster Prevention	June 8, 2006	Chuo Aoyama Pricewaterhouse Coopers
	Japan Aerospace Exploration Agency	June 13, 2006	Chuo Aoyama Pricewaterhouse Coopers
	National Institute of Radiological Sciences	June 20, 2006	Ernst & Young ShinNihon LLC
	National Museum of Art	June 19, 2006	Ernst & Young ShinNihon LLC
	National Museum	June 27, 2006	KPMG AZSA & Co.
	National Research Institute for Cultural Properties	June 12, 2006	Ernst & Young ShinNihon LLC
	Japan Science and Technology Agency	June 14, 2006	Chuo Aoyama Pricewaterhouse Coopers
	RIKEN	June 23, 2006	KPMG AZSA & Co.
	National Agency for the Advancement of Sports and Health	June 27, 2006	Chuo Aoyama Pricewaterhouse Coopers
	Japan Arts Council	December 8, 2006	Deloitte Touche Tohmatsu
	Japan Students Services Organization	June 21, 2006	Ernst & Young ShinNihon LLC
	Japan Agency for Marine-Earth Science and Technology	June 27, 2006	Chuo Aoyama Pricewaterhouse Coopers
	Institute of National Colleges of Technology, Japan	June 23, 2006	Chuo Aoyama Pricewaterhouse Coopers
Center for National University Finance and Management	June 23, 2006	Chuo Aoyama Pricewaterhouse Coopers	
Japan Atomic Energy Agency	June 29, 2006	KPMG AZSA & Co.	
Ministry of Health, Labour and Welfare	Employment and Human Resources Development Organization of Japan	June 27, 2006	KPMG AZSA & Co.
	Organization for Workers' Retirement Allowance Mutual Aid	June 27, 2006	KPMG AZSA & Co.
	Japan Organization for Employment of the Elderly and Persons with Disabilities	June 21, 2006	KPMG AZSA & Co.
	Welfare and Medical Service Agency	June 20, 2006	Ernst & Young ShinNihon LLC
	National Center for Persons with Severe Intellectual Disabilities, Nozominosono	June 20, 2006	Ernst & Young ShinNihon LLC
	Japan Labour Health and Welfare Organization	June 26, 2006	KPMG AZSA & Co.
	National Hospital Organization	June 19, 2006	Ernst & Young ShinNihon LLC
Pharmaceuticals and Medical Devices Agency	June 23, 2006	KPMG AZSA & Co.	

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	National Institute of Biomedical Innovation	June 28, 2006	Deloitte Touche Tohmatsu
	Readjustment of Facilities for Insured Persons and Beneficiaries Organization	June 16, 2006	Deloitte Touche Tohmatsu
Ministry of Agriculture, Forestry and Fisheries	National Livestock Breeding Center	June 15, 2006	KPMG AZSA & Co.
	Bio-oriented Technology Research Advancement Institution	June 9, 2006	KPMG AZSA & Co.
	National Institute of Agrobiological Sciences	June 6, 2006	Ernst & Young ShinNihon LLC
	National Institute for Agro-environmental Sciences	June 2, 2006	KPMG AZSA & Co.
	National Institute for Rural Engineering	May 31, 2006	Chuo Aoyama Pricewaterhouse Coopers
	Forestry and Forest Products Research Institute	June 9, 2006	Chuo Aoyama Pricewaterhouse Coopers
	Fisheries Research Agency	June 1, 2006	KPMG AZSA & Co.
	Agriculture & Livestock Industries Corporation	June 23, 2006	KPMG AZSA & Co.
	Farmers' Pension Fund	June 20, 2006	Ernst & Young ShinNihon LLC
	Agriculture, Forestry and Fisheries Credit Foundations	June 12, 2006	KPMG AZSA & Co.
	Japan Green Resources Agency	June 22, 2006	Ernst & Young ShinNihon LLC
	Ministry of Economy, Trade and Industry	Nippon Export and Investment Insurance	June 16, 2006
National Institute of Advanced Industrial Science and Technology		June 16, 2006	KPMG AZSA & Co.
National Institute of Technology and Evaluation		June 9, 2006	Ernst & Young ShinNihon LLC
Information-Technology Promotion Agency, Japan		June 23, 2006	KPMG AZSA & Co.
New Energy and Industrial Technology Development Organization		June 23, 2006	KPMG AZSA & Co.
Japan External Trade Organization		June 26, 2006	KPMG AZSA & Co.
Japan Nuclear Energy Safety Organization		May 31, 2006	KPMG AZSA & Co.
Japan Oil, Gas and Metals National Corporation		June 19, 2006	Ernst & Young ShinNihon LLC
Ministry of Land, Infrastructure, Transport and Tourism	Organization for Small & Medium Enterprises and Regional Innovation, Japan	June 20, 2006	Ernst & Young ShinNihon LLC
	Public Works Research Institute	June 13, 2006	Deloitte Touche Tohmatsu
	Building Research Institute	June 8, 2006	Deloitte Touche Tohmatsu
	National Traffic Safety and Environment Laboratory	June 19, 2006	KPMG AZSA & Co.
	National Maritime Research Institute	June 16, 2006	Ernst & Young ShinNihon LLC
	Port and Airport Research Institute	June 15, 2006	Ernst & Young ShinNihon LLC
	School for Seafarers Training	June 23, 2006	KPMG AZSA & Co.
	National Agency of Vehicle Inspection	June 20, 2006	Ernst & Young ShinNihon LLC
	Japan Railway Construction, Transport and Technology Agency	June 23, 2006	KPMG AZSA & Co.
	Japan Water Agency	June 28, 2006	KPMG AZSA & Co.
	National Agency for Automotive Safety & Victims' Aid	June 14, 2006	KPMG AZSA & Co.
	Organization for Environment Improvement Around International Airport	June 15, 2006	KPMG AZSA & Co.
	Maritime Disaster Prevention Center	May 31, 2006	Deloitte Touche Tohmatsu
	Urban Renaissance Agency	June 23, 2006	Ernst & Young ShinNihon LLC
	Fund for the Promotion and Development of the Amami Islands	May 31, 2006	KPMG AZSA & Co.
Japan Expressway Holding and Debt Repayment Agency	June 26, 2006	Deloitte Touche Tohmatsu	
Ministry of the Environment	National Institute for Environmental Studies	June 29, 2006	KPMG AZSA & Co.
	Environmental Restoration and Conservation Agency of Japan	June 26, 2006	KPMG AZSA & Co.
	Total (79 Agencies)		

Source: Commission on Policy Evaluation and Evaluation of Incorporated Administrative Agencies, Ministry of Internal Affairs and Communications (2007) Data 27

Meanwhile, in the UK that is referred to as the motherland of IAAs, International Standards on Auditing (UK and Ireland) (ISA (UK/IR)) has been adopted as auditing standards applied to an audit of financial statements in the public sector. ISA (UK/IR) has been applied to the financial statements after the period commencing from December 15, 2004. As for the adoption of ISA (UK/IR), Practice Note No. 10 that stipulates the auditing principles and procedures corresponding to the characteristics of the public sector was revised across the board in January 2006. In addition, the International Organization of Supreme Audit Institutions (INTOSAI), comprising supreme audit institutions around the world, has developed practice notes that stipulate auditing principles and procedures corresponding to characteristics of the public sector, as well as adopting the International Standards on Auditing (ISA) as Financial Audit Guidelines. With regard to an audit of financial statements in the public sector, the auditing standards applied to private enterprises have basically been adopted, and the practice notes corresponding to the characteristics of the public sector have been separately prepared. This procedure has been adopted in Japan as well as internationally. Although Japan's Auditing Standards for IAAs was prepared in March 2001⁴⁾, does it really correspond to the theory of an audit of financial statements and the development of practical operations in the public sector? Therefore, I would like to review whether the present Auditing Standards for IAAs sufficiently reflects the characteristics of the public sector, based on the trends in UK and INTOSAI⁵⁾. (This paper is completely the writer's personal view, but not an official view of the Board of Audit of Japan.)

II Trends of the UK

First of all, let me examine the implementation situations of the audit of financial statements of executive agencies in the UK, which are regarded as a model of IAAs⁷⁾.

1. Legal system

In the UK, executive agencies responsible for policy implementation were founded in ministries based on the Next Steps in 1988. Private enterprise management practices, such as management by setting targets and the adoption of accrual accounting, were introduced in executive agencies. Those practices were thought to serve as a useful reference when the system of IAAs was designed⁸⁾. Each Executive agency, in accordance with the Government Resources and Accounts Act 2000 (GRA Act), shall prepare its financial statements based on the accounting standards applied to private enterprises (GAAP) after the end of a fiscal year concerned, and present them to the Comptroller and Auditor General by November 30 of the next year⁹⁾. These financial statements consist of 1) an operating cost statement,

⁴⁾ Auditing Standards for IAAs was revised in July 2003, according to the revision of Accounting Standards for IAAs, their notes, etc.

⁵⁾ This paper does not mention the trends of INTOSAI, which were already introduced in Vol. 15 of the Government Auditing Review. (See page 77 to 97, Azuma, N (2008).

⁶⁾ In Japan, the National University Corporations were established under nearly the same system design as IAAs in April 2004. In the case of National University Corporations, the auditing by accounting auditors conforms to "Auditing Standards for National University Corporations by Accounting Auditors (Auditing Standards for National University Corporations)" and generally accepted auditing standards in Japan. Since Auditing Standards for National University Corporations is nearly the same as Auditing Standards for IAAs, discussions in this paper also mostly cover Auditing Standards for National University Corporations.

⁷⁾ In the UK, the public sector of the central government consists of ministries, executive agencies, non-departmental public bodies. Although this paper only examines the audit of financial statements of executive agencies in order to make a comparison with IAAs of Japan, the audit of financial statements of ministries and non-departmental public bodies are performed in the same way as that of executive agencies in the UK.

⁸⁾ Okamoto, S (2001) p.11

⁹⁾ GRA Act Section 7(3)(a)

2) a reappraisal profit or loss account, 3) a balance sheet, and 4) a cash flow statement, which are ultimately consolidated into each of financial statements that comprise the Resource Account of a competent ministry. In accordance with the GRA Act, the Comptroller and Auditor General shall submit the certified financial statements of an executive agency and audit report to HM Treasury by January 15 of the next year after the completion of the audit of financial statements¹⁰⁾. HM Treasury, in accordance with the GRA Act, shall present the audit report made by the Comptroller and Auditor General together with the certified financial statements of an executive agency to the House of Commons by January 31 of the next year¹¹⁾. The number of audits of financial statements of executive agencies conducted by the Comptroller and Auditor General is 75 in FY2005-06¹²⁾.

2. Auditing standards

The audits of financial statements of executive agencies by the Comptroller and Auditor General are basically carried out in accordance with the ISA (UK/IR) prepared by Auditing Practices Board (APB). The standards prepared by APB were to be applied to an audit of financial statements in the private sector, but were also applied to the audit of financial statements conducted by the Comptroller and Auditor General based on his decision¹³⁾. The ISA (UK/IR) concretely defines principles and fundamental procedures for an audit of financial statements. However, APB made some modifications based on the ISAs, which was prepared by the International Auditing and Assurance Standards Board (IAASB) so as to make the ISA (UK/IR) adjusted to existing auditing standards applied in the UK and Ireland. Thirty volumes of statement of auditing standards were drawn up from 2004 to 2006 as for the ISA (UK/IR).

3. Practice notes

There are different characteristics in the public sector from the private sector, such as budgetary control by Parliament. Therefore, APB prepared Practice Note No. 10, “Audit of Financial Statements of Public Sector Bodies in the United Kingdom” as a guideline for an audit of financial statements in the public sector, but totally revised it in January 2006 when they adopted the ISA (UK/IR). In Practice Note No. 10 (revised version), auditing procedures were supplemented to each statement of auditing standards. Also, auditing procedures relating to the compliance of accounting procedures with financial accounting laws, including Appropriation Acts, were newly added in order to apply ISA (UK/IR) to the public sector, since ISA (UK/IR) was basically applied to an audit of financial statements in the private sector (refer to Table 2, as for contents of Practice Note No. 10 (revised version)).

4. Internal control

The Accounting Officer of an executive agency (held concurrently by the Chief Executive) shall not only develop and implement internal control based on government accounting regulations of HM Treasury, but also prepare the Statement on Internal Control, which evaluates the effectiveness of the above internal control every year, and submit it to the House of Commons together with financial statements¹⁴⁾. In order to improve the quality of internal control in each ministry and agency of the central government by providing the framework of risk management, HM Treasury

¹⁰⁾ GRA Act Section 7(3)(b)

¹¹⁾ GRA Act Section 7(3)(c)

¹²⁾ NAO (2007) p.31

¹³⁾ APB (2004) p.5

¹⁴⁾ HM Treasury (2000) 21.3

prepared “Management of Risk —A Strategic Overview” in January 2001, and “Management of Risk— Principles and Concepts” as its revision in October 2004. The Comptroller and Auditor General under the accord with HM Treasury shall audit the Statement on Internal Control as well in the process of the audit of financial statements¹⁵⁾. As corporate governance was important in the public sector, in November 2003 APB drew up the Bulletin 2003/1 “Corporate Governance: Requirements of Public Sector Auditors (Central Government)” as guidelines applied to the audit of the Statement on Internal Control in each ministry and agency of the central government. This Bulletin 2003/1 not only provides the framework of corporate governance applied to the central government, but also stipulates the responsibility and items for the reporting of accounting auditors when they audit the Statement on Internal Control in each ministry and agency of the central government.

Table 2: Contents of Practice Note No. 10 (revised version) of APB

Statement of auditing standards	Title
Foreword	The role of the public sector auditor
ISQC(UK/IR) 1	International Standards on Quality Control
ISA(UK/IR) 200	Objective and General Principles Governing an Audit of Financial Statements
ISA(UK/IR) 210	Terms of Audit Engagements
ISA(UK/IR) 220	Quality Control for Audits of Historical Financial Information
ISA(UK/IR) 230	Documentation
ISA(UK/IR) 240	The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements
ISA(UK/IR) 250	Consideration of Laws and Regulation in an Audit of Financial Statements
ISA(UK/IR) 260	Communication of Audit Matters with Those Charged with Governance
ISA(UK/IR) 300	Planning an Audit of Financial Statements
ISA(UK/IR) 315	Obtaining an Understanding of the Entity and its Environment and Assessing the Risks of Material Misstatements
ISA(UK/IR) 320	Audit Materiality
ISA(UK/IR) 330	The Auditor’s Procedures in Response to Assessed Risks
ISA(UK/IR) 402	Audit Considerations Relating to Entities Using Service Organizations
ISA(UK/IR) 500	Audit Evidence
ISA(UK/IR) 501	Audit Evidence – Additional Considerations for Specific Items
ISA(UK/IR) 505	External Confirmations
ISA(UK/IR) 510	Initial Engagements - Opening Balances
ISA(UK/IR) 520	Analytical Procedures
ISA(UK/IR) 530	Audit Sampling and Other Selective Testing Procedures
ISA(UK/IR) 540	Audit of Accounting Estimates
ISA(UK/IR) 545	Auditing Fair Value Measurements and Disclosures
ISA(UK/IR) 550	Related Party Disclosures
ISA(UK/IR) 560	Subsequent Events
ISA(UK/IR) 570	Going Concern
ISA(UK/IR) 580	Management Representations
ISA(UK/IR) 600	Using the Work of another Auditor
ISA(UK/IR) 610	Considering the Work of Internal Audit
ISA(UK/IR) 620	Using the Work of an Expert
ISA(UK/IR) 700	The Auditor’s Report
ISA(UK/IR) 710	Comparatives
ISA(UK/IR) 720	Other Information in Documents Containing Audited Financial Statements
Supplement	Audit of Regularity
Appendix 1	Glossary of Terms
Appendix 2	The legislative framework governing the audit of public sector bodies in the UK
Appendix 3	Risks to regularity and possible control procedures

Source: APB (2006a) pp.1- 2

¹⁵⁾ APB (2003) 24

5. Outsourcing

Although the Comptroller and Auditor General is defined as a legal auditor of the audit of financial statements of executive agencies under the GRA Act, a part of this audit is externally outsourced. There are two steps until the outsourcing assignees are selected. The first step is the National Audit Office (NAO) selects eight audit corporations as assignees for the audit of financial statements and concludes a partnership agreement with them. Among these, four major audit corporations such as Pricewaterhouse Coopers and KPMG are included. The second step is the NAO chooses three audit corporations out of eight based on the characteristics and scale of an organization subject to auditing, and introduces competitive bidding among them. The NAO decides a winning bidder with whom it concludes a consignment contract. The term of the consignment contract is usually for five years, to which the condition that the contract can be dissolved in three years after conclusion of the contract is added. An audit report is signed by the Comptroller and Auditor General as a legal auditor, even if the audit of financial statements is outsourced. The rate of outsourced audits of financial statements by the NAO was 25 percent during FY2005-2006, including organizations subject to auditing other than executive agencies¹⁶⁾.

III Problems of Auditing Standards for IAAs

Since auditing standards applied to the public sector were not prepared in the past in Japan, Auditing Standards for IAAs is regarded as the first government auditing standards prepared in this country. Although it can be said that the historical significance is substantial, it is necessary to always review these standards whether they correspond to the theory of an audit of financial statements and the development of practical operations in the public sector. What I would like to examine here is, based on examination of the trends of the UK and INTOSAI, whether the existing Auditing Standards for IAAs fully reflects the characteristics of the public sector.

1. Audit of regularity

(1) Methods of handling in Auditing Standards for IAAs

As for the audit of regularity, Auditing Standards for IAAs stipulates that “The opinion of an accounting auditor that the description of financial statements is appropriate indicates that there was no significant false description in the financial statements as a whole. It also indicates that the judgment of the accounting auditor that she or he obtained the rational guarantee that it conformed to the laws which had significant influence on the preparation of financial statements¹⁷⁾.” This is because it stipulates that “As the audit of IAAs in accordance with Article 39 of the Act on General Rules for IAAs is for their financial statements, the compliance is to conform to the laws that have significant impacts on financial statements. As IAAs carry out public operations and projects, not only private laws such as the Civil Code and the Company Act, but also various kinds of public laws are often applicable. Therefore, it is considered very difficult and practically unrealistic to exhaustively enumerate all laws which should be applied, as well as their details¹⁸⁾.” As a result, although the compliance with the laws that significantly influence financial statements is

¹⁶⁾ NAO (2006) p.44

¹⁷⁾ “Objectives of Audit” 2, Section 2 of Auditing Standards for IAAs

¹⁸⁾ Study Group of Accounting Standards for Incorporated Administrative Agencies/ Fiscal System Council (2003) p.3

examined in the audit of financial statements of IAAs, an audit or expression of the opinion of whether accounting procedures conform to financial accounting laws is not carried out.

(2) Problems

One of the characteristics of the public sector is that, unlike private enterprises, it has been under the control of laws. That is, the administrative and financial activities of the public sector are fundamentally financed by taxes levied on the Japanese national by the central government. Therefore basic matters among accounting principles and procedures to be followed in the implementation of budgets are provided in Acts, and practical matters are set forth in governmental or ministerial ordinances. Similarly, regarding the accounting principles and procedures for managing assets and liabilities incurred in the implementation of budgets, the basic matters are provided in Acts, and practical matters are set forth in governmental or ministerial ordinances. IAAs are also under the control of the Act on General Rules for IAAs, government ordinances on common matters on organizations, operations and managements for IAAs, ministerial ordinances on the financial affairs and accounting of IAAs, regulations on business and service method of each IAA, and so on. In this way, administrative and financial activities of IAAs are under the control of financial accounting laws. Therefore, in order to confirm whether control by laws is functioning effectively, it is necessary for an accounting auditor to audit and express the opinion of whether accounting procedures conform to financial accounting laws regardless of the influence of laws on financial statements¹⁹⁾.

(3) Global standards

In the UK, in order to use the financial resources of taxes levied on the people by the government only for purposes approved by Parliament, it is acknowledged that accounting procedures are essentially under the control of financial accounting laws. The preparation of financial statements in the public sector is believed to be an important means for fulfilling the responsibility of explaining the compliance of accounting procedures to Parliament. Consequently, it is considered necessary to clearly express an opinion about the compliance of accounting procedures with financial accounting laws separately, as well as to express an opinion about the appropriateness of financial statements. In the formation of audit opinions, the level of judgment of materiality is different between the compliance of accounting procedures with financial accounting laws and the appropriateness of financial statements. Qualitative nature is considered to be more important than quantitative value in an opinion about the compliance with financial accounting laws²⁰⁾. As a result, in the audit of financial statements of executive agencies, the audit and expression of the opinion of whether accounting procedures conform to financial accounting laws are carried out regardless of the influence of laws on financial statements²¹⁾.

On the other hand, according to the Financial Audit Guideline of INTOSAI, an audit of financial statements in the public sector includes not only the audit of whether description of financial statements is appropriate, but also the audit of whether accounting procedures conform to financial accounting laws. Since many people expect a report on

¹⁹⁾ There was a case of the National Agricultural Research Organization (NARO), one of IAAs, in FY2001 in which it was acknowledged that it was necessary for an accounting auditor to audit and express whether the accounting procedures conformed to financial accounting laws. In the construction work of a manure shed, NARO violated financial accounting laws by preparing a false document in which they said that the construction work was completed in the fiscal year although they did not start work, and by paying the full amount of the construction cost before the commencement of work (Improper amount pointed out was 6.52 million yen). (Board of Audit of Japan (2003a) pp.550-552)

²⁰⁾ In other words, the level of materiality of compliance with financial accounting is set forth lower than that for the appropriateness of financial statements (APB (2006a)310).

²¹⁾ APB (2006a) 286

the compliance of accounting procedures with financial accounting laws even when it is not legally required, an accounting auditor shall draw up an audit plan and implement audit procedures, keeping in mind to report separately the compliance with financial accounting laws²²⁾. Also, assessment of the compliance of accounting procedures with financial accounting laws shall be carried out aside from assessment of the appropriateness of financial statements²³⁾. This is because accounting procedures may be against financial accounting laws, even if they are appropriately described in the financial statements. Thus, in global standards for an audit of financial statements in the public sector, an audit and expression of the opinion of whether accounting procedures conform to financial accounting laws are carried out regardless of the influence of laws on financial statements.

2. Audit of statements of account

(1) Methods of handling in Auditing Standards for IAAs

As for the audit of statements of account, Auditing Standards for IAAs stipulates that “An opinion shall be expressed whether statements of account correctly reflect the settlement of account in accordance with the budget classifications made by the head of the incorporated administrative agency.”²⁴⁾ This is because it is stipulated that “The structure of a medium-term target, a medium-term plan and ex-post facto evaluation is introduced in IAAs in order to perform activities efficiently, and subsequently a comparison with prior planning is thought to be important. So for this reason, regarding statements of account, it is considered that an accounting auditor’s opinion of whether statements of account correctly reflect the settlement of account in accordance with the budget classifications is attached. The audit based on Article 39 of the Act on General Rules for IAAs covers not only the audit of financial statements and business reports (accounting related only) similar to an audit by Company Act, but also the audit of statements of account for comparison between the budget and settlement of account that reflects the method of operation of IAAs. However, it is considered that the audit of financial statements is the core of the auditing system in IAAs.”²⁵⁾ As a result, in the audit of financial statements of IAAs, an audit or expression of the opinion of whether accounting procedures conform to the budget is not carried out, although the audit of statements of account from the aspect of appropriateness of description is carried out.

(2) Problems

One of the characteristics of the public sector is that, unlike private enterprises, it has been under the control of budgets. That is, the principle of administrative and financial activities of the public sector is to allocate revenues from taxes that the government levies according to policy purposes. Since Japanese nationals have various interests, such revenues are allocated according to the budgets deliberated and decided in the Diet that consists of representatives of the nationals. An operational-expenses subsidies, national subsidies, facility expenses and government investment are granted to IAAs every year, and all of these are included in the budgets of the competent ministries and are decided in the Diet²⁶⁾. In this way, the administrative and financial activities of IAAs are controlled through the budgets by the Diet. Therefore, it is necessary for an accounting auditor to audit and express the opinion of whether accounting

²²⁾ INTOSAI (2007a) p.3

²³⁾ INTOSAI (2007c) p.14

²⁴⁾ “Basic Principles” 1(3), “Reporting Standards” No.1, Section 5 of Auditing Standards for IAAs

²⁵⁾ Study Group of Accounting Standards for Incorporated Administrative Agencies/ Fiscal System Council (2003) p.2

²⁶⁾ The total amount of the income budget of IAAs (101 agencies) in FY2007 was 55.57 trillion dollars. (Commission on Policy Evaluation and Evaluation of Incorporated Administrative Agencies, Ministry of Internal Affairs and Communications (2007) Document 20-1)

procedures conform to the budgets in order to confirm that the control through the budgets functions effectively²⁷⁾.

(3) Global standards

In the UK, the expenditure budget of a single fiscal year is enacted as the Appropriation Act and the Consolidated Fund Act. These serve as the most important financial accounting laws that accounting procedures should conform to. For this reason, an audit of the effectiveness of budgetary control is carried out as a part of the audit of compliance with financial accounting laws. That is, in order to make financial statements in the public sector fulfill the responsibility of explanation for parliament, it is necessary to clearly express opinions of the compliance with the budgets separately, in addition to the expression of opinions on the appropriateness of financial statements in the audit report. In the formation of audit opinions, the level of judgment of materiality is different between the compliance with the budgets and the appropriateness of financial statements. Qualitative nature is considered to be more important than quantitative value in the compliance with the budgets²⁸⁾. As a result, in the audit of financial statements of executive agencies, the audit and expression of the opinion of whether accounting procedures conform to the budgets are carried out²⁹⁾. Table 3 below shows a comparison of the audit opinion sections in an audit report between our country and the UK in the case of an unqualified opinion.

On the other hand, according to the Financial Audit Guideline of INTOSAI, an audit of financial statements in the public sector includes not only the audit of whether the description of financial statements is appropriate, but also the audit of whether accounting procedures conform to budgets. Since many people expect a report on the compliance with budgets even when it is not legally required, an accounting auditor shall draw up an audit plan and implement audit procedures, keeping in mind to separately report the compliance with budgets³⁰⁾. Also, assessment of the compliance with budgets shall be carried out aside from assessment of the appropriateness of financial statements³¹⁾. This is because accounting procedures may be against budgets, even if they are appropriately reflected in the financial statements. Thus, in the global standards for an audit of financial statements in the public sector, an audit and expression of the opinion of whether accounting procedures conform to budgets are carried out.

²⁷⁾ Although not cases involving IAAs, there were cases of National University Corporations, Hiroshima University in FY1999-2003 and Saga University FY2003 in which it was acknowledged that it was necessary for an accounting auditor to audit and express whether the accounting procedures conformed to the budgets. In those cases, Hiroshima University and Saga University purchased more medical supplies and hospital equipments than were approved by the budgets, but did not take proper accounting procedures for them in the relevant fiscal years. Also, both universities paid bills from the budgets of the next fiscal year by asking traders to submit bills with a blank date, which universities filled in with a suitable date. Thus their accounting procedures were against the budgets (Improper amount pointed out was 771.72 million yen). (Board of Audit of Japan (2005) pp.481-484)

²⁸⁾ In other words, the level of materiality of compliance with budgets is set forth lower than that of appropriateness of financial statements (APB (2006a) 310).

²⁹⁾ APB (2006a) 286

³⁰⁾ INTOSAI (2007a) p.3

³¹⁾ INTOSAI (2007c) p.14

Table 3: Comparison of Audit Reports (audit opinion only)

(1) Japan

	Audit Report of an Independent Auditor
(Subject of audit)	
Omission	
(Outline of audit performed)	
Omission	
(Audit result of financial statements and so on)	As a result of the audit, the opinion of the auditing corporation is as follows:
	(1) It is approved that the financial statements (excluding documents (drafts) related to the disposition of profits) based on Accounting Standards for Incorporated Administrative Agencies and generally accepted accounting standards, properly describe the financial standing, administrative operation, state of cash flow and state of operational cost of administrative service of the incorporated administrative agency ○○○○ in all the important matters.
	(2) It is approved that the documents (drafts) related to the disposition of profits are in accordance with laws.
	(3) It is approved that the business report (limited to the portion of accounting) accurately describes the state of service management of the incorporated administrative agency.
	(4) It is approved that the statements of account accurately describe the state of settlements of account based on the classification of budgets made by the head of the incorporated administrative agency.

Source: The Japanese Institute of Certified Public Accountants (2003) pp.5-6

(2) The United Kingdom

	The Certificate and Report of the Comptroller and Auditor General to the House of Commons
(Respective responsibilities of the Accounting Officer and auditor)	
Omission	
(Basis of audit opinions)	
Omission	
(Opinions)	In my opinion,
	(1) The financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Department's affair as at <i>[insert date]</i> and the net resource outturn, resources applied to objectives, recognized gains and losses and cash flows for the year then ended.
	(2) The part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions issued under the Government Resource and Accounts Act 2000.
	(3) In all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Source: From APB (2006b) pp.4-6

3. Audit of fraud

(1) Methods of handling in Auditing Standards for IAAs

As for the audit of fraud, Auditing Standards for IAAs stipulates that “Opinions on financial statements and others shall include opinions on whether there are any falseness, errors or illegal activities that have significant influence on financial statements.”³²⁾ This is because it is stipulated that “In the auditing of financial statements in corporate accounting, it is a common practice to audit without letting any falseness, errors or illegal activities that have significant influence on financial statements pass unnoticed. In an audit of IAAs by accounting auditors, as they are characteristically public, the discovery of illegal activities of such agencies is a matter of more concern than that in an audit of private enterprises.”³³⁾ Also, in the practice notes of the Japanese Institute of Certified Public Accountants (JICPA) it is stipulated that opinions shall be expressed on whether any falseness, errors or illegal activities that have significant influence on financial statements by any persons inside an IAA were found³⁴⁾. As a result, in the audit of financial statements of IAAs, the audit of fraudulent acts is carried out only for persons inside IAAs, but not for outsiders.

(2) Problems

One of the characteristics of the public sector is that, unlike private enterprises, it provides administrative services without going through the market mechanism. That is, in the public sector, subsidies, benefits and so on are granted, or money is loaned to beneficiaries who fit certain conditions regulated by the laws in order to improve the well-being of Japanese national. Those subsidies and others are granted or loaned by applications of beneficiaries. Also, the taxes levied on the national are used for financial resources of providing administrative services. Those taxes include not only withholding tax, but also self-assessed income tax. Thus, if examination related to applications of subsidiaries or returns of income tax is not properly implemented in the public sector, the risk of fraudulent acts by outsiders increases. Some IAAs, as an agency which implements policies of the competent ministry, grant subsidies or benefits to beneficiaries who fit certain conditions regulated by the law. In this way, as the risk of the fraudulent acts by beneficiaries is high in administrative services provided by IAAs, it is necessary for an accounting auditor to audit the fraudulent acts by outsiders of the relevant IAA³⁵⁾.

(3) Global standards

In the UK, the risk of fraudulent acts, that should be kept in mind in carrying out an audit of financial statements, includes false description by means of misappropriation of assets and false description by means of window-dressing accounting. It is acknowledged that the risk of fraudulent acts by outsiders is high because, in the public sector, subsidies and benefits are given for free to people to achieve policy goals, or taxes are levied on the people to acquire financial resources to provide administrative services. That is, it is acknowledged that the risk of false description by means of misappropriation of assets conducted by outsiders is high in the public sector. As a result, the

³²⁾ “Basic Principles” 2, “Reporting Standards” No.1, Section 5 of Auditing Standards for IAAs

³³⁾ Study Group of Accounting Standards for Incorporated Administrative Agencies/ Fiscal System Council (2003) p.3

³⁴⁾ Japanese Institute of Certified Public Accountants (2003) p.5

³⁵⁾ There was a case of the Japan Society for the Promotion of Science (JSPS), one of IAAs, in FY2002-2006 in which it was acknowledged that it was necessary for an accounting auditor to audit the fraudulent acts by outsiders of the relevant IAA. In the JSPS, in the bookkeeping of the subsidiary for research expenditures, representatives of researches ordered traders to perform false transactions and to prepare fictitious delivery slips and invoices. Also, as they asked the research institutes to which they belong to pay them money for false transactions and kept separate accounts, the subsidiary was excessively granted. (Improper amount pointed out was 26.1 million yen) (Board of Audit of Japan (2007) pp.579-581)

fraudulent acts by outsiders are also examined in the audit of financial statements of executive agencies³⁶⁾.

Meanwhile, according to the Financial Audit Guideline of INTOSAI, in the public sector, in addition to the risk of fraudulent acts by insiders of the organization subject to audit, there is a high risk of fraudulent acts by outsiders such as recipients of benefits. Consequently, an accounting auditor shall draw up an audit plan and implement audit procedures, keeping in mind the risk of fraudulent acts by outsiders³⁷⁾. Thus, in the global standards for an audit of financial statements in the public sector, fraudulent acts by outsiders are also subject to audit.

4. Audit of internal control

(1) Methods of handling in Auditing Standards for IAAs

As for the audit of internal control, Auditing Standards for IAAs stipulates that “After understanding the situation of internal control of an IAA and provisionally evaluating the risk of control, and also considering an inherent risk of items of financial statements, an accounting auditor shall prepare an audit plan related to the control evaluation procedures, as well as an audit plan related to the substantive procedures corresponding to the level of risk to be found, and then shall decide on the audit procedure to be performed, the time and range of execution of the audit.”³⁸⁾ This is because it is stipulated that “The head of an IAA shall develop internal controls for the general management of operations, consisting of the internal control system and internal environment that influences the internal control system. The internal controls subjective to audit are parts related to the preparation of proper financial statements and securing of the compliance with laws that have significant influence on financial statements.”³⁹⁾ As a result, assessment of internal control for the purpose of deciding the audit procedures is carried out; however, a report of whether these internal controls function effectively is not made in the audit of financial statements of IAAs.

(2) Problems

One of the characteristics of the public sector is that, unlike private enterprises, it engages in activities to achieve policy goals under the control of budgets and laws. For this reason, internal controls carried out by the staff of an organization are developed and implemented in the public sector for the purpose of 1) efficient implementation of policies and achievement of policy goals, 2) securing of the reliability of financial reporting and performance (outcome) reporting, 3) securing of the compliance with related laws, and 4) safeguarding of assets⁴⁰⁾. It is essential to assess whether internal controls are developed and implemented properly, so as to prevent risks that may hamper the purposes ranging from 1) to 4) in order to fulfill the roles the public sector. IAAs receive unrestricted operational-expense subsidies as agency of policy implementation of the competent ministries. On the other hand, they take an active role to achieve medium-term goals set up by the competent ministers. In this way, IAAs are controlled by the government that sets up goals for them under the mechanism in which they bring out independence and initiatives. Therefore, an accounting auditor needs to audit and report whether internal controls function effectively⁴¹⁾.

³⁶⁾ APB (2006a) 370

³⁷⁾ INTOSAI/FAS (2007) 3.a

³⁸⁾ “Preparation of Audit Plan”3, “Practice Standards” No.2, Section 4 of Auditing Standards for IAAs

³⁹⁾ Study Group of Accounting Standards for Incorporated Administrative Agencies/ Fiscal System Council (2003) p.7

⁴⁰⁾ INTOSAI (2004) pp.6-11

⁴¹⁾ There was a case of RIKEN, one of IAAs, in FY2002 in which it was acknowledged that it was necessary for an accounting auditor to audit and express whether internal control was functioning effectively. In this case, accounting books including a book for managing goods used in research were not provided in RIKEN as they were expected to be. Also, there was a case of inappropriate entries in books in which laboratory rooms were described as a place in control in the fixed asset ledger, although the use of those rooms was discontinued; in addition paper work for disposal was not appropriate, as the date of application for removal of those rooms was rewritten. In this way, appropriate managements were not implemented (Improper amount pointed out was 891.62 million yen). (Board of Audit of Japan 2003b) pp.517-523)

(3) Global standards

In the UK, the Accounting Officer shall prepare the Statement on Internal Control for self-assessment of the effectiveness of internal control every year, include it in the accounts of the relevant executive agency together with financial statements and then provide it to the House of Commons. Here, internal control is regarded as the procedures and schemes set in the organization by the relevant executive agency in order to achieve policy goals as well as to secure public funds and assets. The Comptroller and Auditor General under an accord with HM Treasury shall audit the Statement on Internal Control in the process of an audit of financial statements. This audit is a “review” that is distinguished by an “audit” in the proper sense. The Comptroller and Auditor General must report those cases in an audit report on financial statements, such as a case in which the Statement on Internal Control does not meet the disclosure requirements from HM Treasury, a case in which expression may give a false impression, or a case in which data is different from that which was obtained in the process of an audit of financial statements⁴²⁾. As a result, in the audit of the financial statements of an executive agency, the audit of whether internal controls function effectively is carried out and a report is made only if above-mentioned cases are found.

On the other hand, according to the Financial Audit Guideline of INTOSAI, an audit of financial statements in the public sector includes audit of whether the description of financial statements is appropriate and whether internal controls function effectively. Since many people expect a report relating to effectiveness of internal control, even when it is not legally required, an accounting auditor shall draw up an audit plan and implement audit procedures, keeping in mind to report the effectiveness of internal control separately⁴³⁾. When an accounting auditor audits the effectiveness of internal controls and finds defects, they shall report them accordingly⁴⁴⁾. Thus, in the global standards for an audit of financial statements in the public sector, the audit of the effectiveness of internal control is carried out and a report is made if defects are found.

5. Audit of economy and efficiency

(1) Methods of handling in Auditing Standards for IAAs

As for the audit of economy and efficiency, Auditing Standards for IAAs stipulates that “An accounting auditor must exert efforts to find out inefficient transactions of an IAA in the process of auditing, by fully using their professional competence as an expert of accounting and knowledge obtained through work experience.”⁴⁵⁾ This is because it is stipulated that “As it is a great concern of the competent minister, those concerned and the Japanese national on whether operations and projects of IAAs are implemented effectively and efficiently, it is seemingly expected that inefficient transactions are pointed out by an accounting auditor. Therefore, in the case of finding inefficient transactions in the process of the audit of financial statements, the accounting auditor of an IAA must report them to the head and the inspector of the IAA, as well as to the competent minister via the head of the IAA for handling them properly.”⁴⁶⁾ As a result, in the audit of financial statements of IAAs, auditing is carried out from the aspects of the appropriateness of financial statements, the compliance of laws as well as economy, efficiency and effectiveness.

⁴²⁾ APB (2003) 47

⁴³⁾ INTOSAIS (2007b) p.3

⁴⁴⁾ IAASB (2007) A126

⁴⁵⁾ “Audit Practice”6, “Practice Standards” No.3, Section 4 of Auditing Standards for IAAs

⁴⁶⁾ Study Group of Accounting Standards for Incorporated Administrative Agencies/ Fiscal System Council (2003) p.6

(2) Problems

One of the characteristics of the public sector is that, unlike private enterprises, it engages in administrative activities to achieve policy goals within a certain budget range. The public sector carries out administrative activities to achieve policy goals, such as improving the welfare of the Japanese national. Institutions in the public sector use the financial resources of taxes levied on the Japanese national, and provide administrative services for the Japanese national without going through the market mechanism. Thus, the administrative operations of the public sector are not evaluated on the principles of competition, and as such, it is impossible to evaluate its performance only on the basis of financial data. Those who have professional competence in the relevant administrative field and work experience have to additionally evaluate its performance from the aspects of economy, efficiency and effectiveness based on financial data as well as non-financial performance data. IAAs work as agencies to implement the policies of the competent ministries, and the scope of their activities is extended to all administrative fields. Although accounting auditors are expected to utilize their professional competence relating to accounting auditing, which has been cultured through experience in corporate accounting as well as knowledge accumulated through work experience, their professional competence or their work experience relating to national administrative fields is not expected⁴⁷⁾.

(3) Global standards

In the UK, the main tasks of the Comptroller and Auditor General consist of the audit of financial statements based on the GRA Act, and performance audit based on the National Audit Act 1983. Among these, performance audit is defined as the audit of public resources from the aspects of economy, efficiency and effectiveness. Most of the staff members engaged in the audit of financial statements are Chartered Accountants or trainees who are studying to acquire the certification, while those engaged in performance audit are required to have professional competence related to national administrative fields such as defense, environment and education. Also, the audit from the aspects of economy, efficiency and effectiveness is excluded in the Practice Note of APB for the audit of financial statements.⁴⁸⁾ As a result, the audit of financial statements and performance audit of executive agencies are carried out separately, and the audit from the aspects of economy, efficiency and effectiveness is not carried out in the audit of financial statements.

INTOSAI classifies the government auditing into financial audit, compliance audit and performance audit. As for financial audit, INTOSAI decided to adopt Financial Audit Guidelines that converge with ISA of the IAASB. As for compliance audit and performance audit, INTOSAI decided to adopt Compliance Audit Guidelines⁴⁹⁾ and Performance Audit Guidelines developed independently by INTOSAI. The background is that many more countries have introduced the accrual accounting system into the public sector, creating an environment where the standards applied to an audit of financial statements in the private sector can be applied to that of the public sector. Thus, in the global standards for government auditing, the audit of financial statements and performance audit are carried out separately, and the audit from the aspects of economy, efficiency and effectiveness is not carried out in the audit of financial statements.

⁴⁷⁾ There was a case of Readjustment of Facilities for Insured Pensions and Beneficiaries Organizations (RFO), one of IAAs, in FY2005 in which it was acknowledged that it was necessary for an accounting auditor not to be engaged in the audit of economy and efficiency, but exclusively in the audit of appropriateness of financial statements and compliance of accounting procedures. In this case, in the calculation of the approximate market price of government-provided state-owned goods in RFO, calculation of the writing off of art objects up to the current price (10 percent) was made. This was because RFO regarded the useful life of them as being expired, although those art objects had been regarded as assets not subject to depreciation. In this way, since their current prices were underestimated, the amount of capital and so on in the financial statements of the organization was not described correctly (Improper amount pointed out was 134.16 million yen). (Board of Audit of Japan2006) pp.216-219

⁴⁸⁾ APB (2006a) 16

⁴⁹⁾ INTOSAI regards an audit of compliance of accounting procedures carried out in the audit of financial statements as compliance audit (INTOSAI/CAS (2007)3.). Therefore, many parts of the Compliance Audit Guidelines are repeated in the Practice Note of Financial Audit Guidelines.

IV Conclusion

The audit of IAAs by an accounting auditor is carried out in accordance with Auditing Standards for IAAs and generally accepted auditing standards in Japan. The purpose of preparing Auditing Standards for IAAs, in addition to auditing standards applied to private enterprises, was to lay down auditing principles and procedures corresponding to the characteristics of IAAs, as they belong to the public sector. One of the characteristics of the public sector is that it is under the control of financial accounting laws and budgets. In the present Auditing Standards for IAAs, there are some problems to be solved. For instance, the audit of compliance with laws that significantly influence financial statements is carried out, but the audit of compliance of accounting procedures with financial accounting laws and budgets is not carried out or no expression of opinions is made. In the present Auditing Standard for IAAs, too much emphasis is placed on the audit of appropriateness of financial statements, but not on the audit of compliance of accounting procedures itself. Meanwhile, the audit from the aspects of economy, efficiency and effectiveness that cannot be fully covered by professional competence is required.

Auditing Standards for IAAs is the first government auditing standards prepared in Japan, and its historical significance is substantial. However, an audit of financial statements in the public sector should be constantly reexamined as to whether they correspond to the theory of an audit of financial statements and development of practical operations. Since the convergence of auditing standards in the public sector has been internationally advanced, it is necessary to raise the level of auditing standards in our country, aiming at global standards. This paper introduced some examples of global standards including Practice Note No. 10 of the UK, which is regarded as the motherland of IAAs, and practice notes of INTOSAI, which is promoting convergence with ISA. It is my pleasure if this paper will be helpful to review Auditing Standards for IAAs in our country.

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