

## OUTLINE OF AUDIT RESULTS—FY2007 AUDIT REPORT—

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# CHAPTER I OUTLINE OF AUDIT ACTIVITIES

## Section 1. Audit Policies

The Board of Audit established its Basic Policy on Audit Activities for the year 2008 as follows:

### Basic Policy on Audit Activities for 2008

(As established on September 21, 2007)

#### 1. Mission of the Board of Audit

The Board of Audit has the following statutory mission as a constitutional organization, independent of the Cabinet.

The Board shall audit all of the final accounts of revenues and expenditures of the State every year and also such accounts as are provided for by the Board of Audit Law.

The Board shall constantly conduct audits and review the public accounts to ensure their adequacy and to rectify defects, and based on its audit results, shall verify the final accounts of revenues and expenditures of the State.

The Board shall send the results of the audit in the form of the Audit Report to the Cabinet. This Report, together with the final accounts of revenues and expenditures of the State, shall be submitted to the Diet.

#### 2. Social and Economic Trends and the Situation Surrounding the Board of Audit

##### (1) Japan's Social and Economic Trends and Current Fiscal Position

In recent years, Japan's social and economic situation has been changing drastically with the trend towards the rapidly declining birthrate and aging population, economic globalization, the innovation and spread of information and communication technology and limitation due to environmental problems. The administration systems that have supported and contributed to Japan's social and economic development must respond to these changes.

As for the fiscal position of the State government, continual issuance of government bonds is steadily increasing the outstanding balance, which is estimated to reach about 547 trillion yen at the end of FY2007. The total expenditure required for redemption of the national debt and payment of the interest account is approximately 20.9 trillion yen in the budget for FY2007, and comprises about 25% of General Account expenditures, which imposes a major challenge on the sound fiscal position.

The Government also is promoting reforms in several fields, including the economy, finance and

administration systems.

## (2) Situation Surrounding the Board of Audit

In recent years, greater emphasis has been placed on administrative activities such as post-verification of budget execution and policies, and implementation of accountability. Various efforts have been undertaken including budget system reforms aimed at evaluation of budgets and performance outcome mainly by linking budgets and the settlement of accounts in each policy, implementation of policy evaluations and evaluations of independent administrative agencies, and disclosure of assets and debts of Special Accounts prepared by reference to practice of corporate accounting based on the law concerning Special Accounts.

Moreover, the importance of understanding budget execution results and reflecting these in subsequent budgets is being deliberated in the Diet from the viewpoint of enhancing and strengthening fiscal administration control by the Diet. Based on a request to the Cabinet by the Diet to submit the final accounts of the State earlier, the Board of Audit has been striving to submit its audit report to the Cabinet earlier, which helps the Diet deliberate the final accounts of the State earlier and enables the Diet to further reflect the audit results in the budget. Furthermore, since the Board of Audit has been receiving audit requests by the Diet under the provisions of Article 105 of the Diet Law in recent years, it has been steadily undertaking the audits related to these requests and reporting the audit results to the Diet. For the purpose of strengthening and utilizing the function of audits and thereby contributing to enhancement of the Diet's deliberations of the final accounts of the State, the Board of Audit Law was amended in November 2005, resulting in expanding of audit coverage, an obligation to accept field audits, and reporting of its audit findings at any time as needed to the Diet.

As a result, restoring sound fiscal administration has become an important issue. The role of the Board of Audit has taken on more importance, as greater emphasis is placed on post-verification of administration and finance, reflection of the results in budgets and policies and implementation of accountability, and public expectations regarding audit functions have grown.

### 3. Basic Policy on Audit Activities

The Board has been trying to conduct audits in order to adequately respond to public expectations as well as to the social and economic trends at all times. Under the above-mentioned situation, the Board continues to pay sufficient attention to the public interests and make every effort to ensure the strict and fair discharge of its duties.

#### (1) Focus of Audit

In response to Japan's social and economic trends and its current fiscal position, the Board has decided to focus its audit activities on the following policy areas of public administration.

- (a) Social Security
- (b) Public works
- (c) Education, science and technology
- (d) Defense
- (e) Agriculture, forestry and fisheries
- (f) Economic cooperation
- (g) Small and medium enterprises
- (h) Environmental protection

(i) Information technology (IT)

In addition, the Board enhances the crossover audits on policies jointly conducted by several ministries and agencies and the cases commonly related with several ministries and agencies, and also responds to the matters of much social concern timely and properly by conducting flexible audit, if necessary.

(2) Audit from various audit aspects

The Board conducts audits not only to identify and disclose cases of inappropriate or improper acts but also to evaluate the performance. Moreover, the Board conducts audits with a focus on the need of the current systems of administration, if necessary.

The Board has conducted audits from the following aspects.

-Aspect of Accuracy-

Whether or not the statements of accounts accurately reflect the financial situation such as execution of the budgets.

-Aspect of Regularity-

Whether or not the accounts of projects and programs are administered in conformity with the budgets, laws and regulations.

-Aspect of Economy-

Whether or not the implementation of projects and programs or budget were administered with the minimum cost.

-Aspect of Efficiency-

Whether or not the projects and programs gain the maximum results and have a cost-efficient outcomes.

-Aspect of Effectiveness-

Whether or not the projects and programs achieve the planned goals and produce the intended effects.

-Other Audit Aspects-

The Board will conduct audits from the aspects of accuracy and regularity, more carefully examining accounting transactions because the inappropriate or improper transactions in some ministries were found these days, and will pay attention to the competitiveness and the transparency of contracts, through examining propriety of contract methods such as negotiated contract, and adequacy of the reason for selection of vendors, and confirming as to whether procedures for bidding and contracts are taken enough to secure fair competitive bidding. Moreover, in the light of the serious economic and financial conditions in recent years, the Board will put greater importance on the aspects of economy, efficiency and effectiveness. From the aspect of effectiveness, in particular, the Board will endeavor to review the results of projects and programs, and budgets actively. In such cases, the Board conducts audit with attention to auditees' self-evaluation of their policies. If there is any problem about the projects and programs

implementation and the budget execution, the Board will thoroughly investigate the causes and consider possible remedies.

In addition, to contribute to the improvement of the administrative and financial transparency and accountability, and project implementation, the Board will analyze and evaluate the public finance such as State's final accounts of revenues and expenditures and more closely audit the financial status of the special accounts and the independent administrative agencies. Through conducting audit on financial statements of special account newly prepared by reference to practices of corporate accounting, the Board conducts audit with careful attention to problems regarding public accounts.

(3) The approach corresponding to a condition of internal control

Since the conditions of internal control such as internal audits and internal checks and balances, etc., influence the fair presentation of accounting to be ensured in auditees, the Board pays sufficient attention to their effectiveness. Also the Board ensures the effectiveness of the internal control for ensuring the fair presentation of accounting by requesting the auditees to improve their internal control system, if necessary.

(4) Follow-up of the audit findings

To ensure that the results of audit should be reflected adequately and effectively in the drafting and execution of budget and project implementation by taking remedial and preventative measures against improper and irregular cases found by audit, the Board, thereafter, follows up the situations such as measures taken.

Moreover, concerning the improper accounting in the Audit Report, the Board conducts audit necessary for improving similar cases in other auditees.

(5) Cooperation with the Diet

The Board always pays attention to the deliberations in the Diet and to the request, which is necessary for the examination and research by the Diet.

(6) Audit capacity building

The Board will attempt to build up audit capacity through developing new auditing method to deal with more complicated society and economy and corresponding changes in administrative activities.

The Board will seek ways to expand its audit activities on accounting and its relevant matters by:

- (1) studying diversification of auditing method and audit areas
- (2) fostering the auditors who have the ability to audit in the specialized areas
- (3) promoting IT in the audit activities and

- (4) utilizing the audit tools.

#### 4. Designing appropriate audit plan

The Board of Audit designs and carries out an appropriate audit plan that aims to effectively and efficiently achieve its mission, based on the above mentioned Basic Policy on Audit Activities.

In the audit plan, each division establishes its priority audit issues, on which the Board should focus in audits, taking into full consideration the scale and contents of the budget of auditees, measures, projects and programs, the conditions of internal control such as internal audits and internal checks, etc. the previous audit's status and results, etc.

## Section 2. Audit Implementation

### [Coverage of audit]

Matters for which an audit by the Board of Audit is required are described below, based on the provision of Article 22 of the Board of Audit Law.

- ① Monthly accounts of revenues and expenditures by the State
- ② Acceptance and distribution of cash and goods owned by the State, and State properties
- ③ Charge and collection of government claims and issuance and repayment of Government bonds and other obligation of the State
- ④ Acceptance and distribution of cash, precious metals and securities by the Bank of Japan on behalf of the State
- ⑤ The accounts of juridical persons more than half of whose capital is invested by the State
- ⑥ The accounts to be subject to audit by the Board of Audit in accordance with a provision of any law

In addition, based on the provision of Article 23, Section 1 of the Board of Audit Law, the Board may audit the following matters when the Board considers necessary or at the request of the Cabinet.

- ⑦ Securities which are owned or taken into custody by the State, and cash and goods taken custody of by the State
- ⑧ Acceptance and distribution of cash, goods and securities by entities other than the State, on behalf of the State
- ⑨ The accounts of such bodies as are given subsidies, incentive grants, bounties or other financial assistance such as loan or indemnity of loss directly or indirectly by the State
- ⑩ The accounts of bodies a part of whose capital is invested by the State
- ⑪ The accounts of business enterprises operating under the Commerce Law whose shares are wholly or partly owned by the Government Corporations subject to audit by the Board in accordance with the provisions in ⑤ or ⑩
- ⑫ The accounts of bodies for which the State guarantees payment of the principal of or the interest of debt

- ⑬ The accounts of contractors of construction and other services with, trustees of works and operations by, or suppliers of goods to the State and juridical persons (hereafter “the State, etc.”) under the provision of ⑤ (in regard to the contracts concerned)

In addition to the State accounts, accounts audited for 2008 (auditing period: October 2007 through September 2008) were the accounts of 225 juridical persons including government financial institutions, public corporations and independent administrative agencies as categorized in ⑤, the account of Nippon Hoso Kyokai (NHK) as categorized in ⑥, the accounts of 5,058 public corporations as categorized in ⑨, the accounts of 5 juridical persons as categorized in ⑩, the accounts of 51 juridical persons as categorized in ⑪, and the accounts of 318 juridical persons as categorized in ⑬, all related to contracts with the State.

#### [In-office documentary audit and field audit]

In-office documentary audit and field audit are the two main methods of audit.

In-office documentary audit is the examination of the statements which show the numeric results of accounting transactions, with the vouchers and other supporting documents such as contract documents, invoices and receipts, which are submitted from the auditees in accordance with the Regulations for the Verification of Accounts enacted by the Board.

On the other hand, field audit is conducted by dispatching auditors to the offices under the ministries and agencies, auditees, to examine relevant accounting books and other necessary documents for reviewing the real implementation of projects and programs and to ask the relevant officers for the explanation.

Audit implementation by using the above-mentioned two methods in year 2008 are as follows.

- (a) In-office documentary audit covered more than 162 thousand statements and 52,920 thousand sheets of vouchers and supporting documents for the fiscal 2007.
- (b) Field audit covered more than 3,300 among the 34,300 auditees and also covered the above-mentioned 5,058 bodies with subsidies or other financial assistance by the State as shown in the following table. The Board spent 38,200 man-days on the field audit.

Auditee classification	The Number of unit to be audited (A)	The actual number of units audited (B)	Field audit implementation rate (%) (B/A)
Head offices of ministries, agencies and corporations	4,322	2,015	46.6
Prefectural branches of ministries and agencies	7,857	1,168	14.8
(Subtotal)	12,179	3,183	26.1
Railway stations and post offices	22,157	150	0.6
(Total)	34,336	3,333	9.7

Based on the results of the audit, the Board of Audit sends inquiry letters on audit findings to receive the answers and official views of the auditees concerned. About 900 inquiry letters were sent relating to the audit conducted in year 2008.