

I Outline of audit activities

Basic Policy on Audit for 2011

(As established on September 3, 2010)

1. Missions of the Board of Audit

The Board of Audit (the Board) has the following missions as a constitutional organization independent of the Cabinet.

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

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

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

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

In recent years, Japan's society and economy have faced difficult challenges, such as a sharp decrease in the population, an increase in society security expenses due to the decreasing birthrate and the aging population, structural changes in domestic and overseas economies, and global environment problems. As a result, the public administration is required to cope with these challenges.

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 637 trillion yen at the end of FY2010. In the budget for FY2011, the level of dependence on public bonds is about 48% and the total expenditure required for redemption of national debts comprises about 22% of the general account expenditure, which imposes a major challenge in achieving sound fiscal position.

In this situation, the State government has been striving to achieve fiscal soundness by securing stable financial sources, reducing the fiscal deficit, and reviewing the expenditure, etc. To this end, the State government has also been tackling wasteful spending by accurately grasping the status of execution in projects and programs, and enhancing transparency and disclosure over recent years.

Moreover, the importance of grasping the result of the State budget execution and reflecting these in following budgets is deliberated in the Diet from the viewpoint of enhancing and strengthening fiscal administration control by the Diet.

Because the Diet requested the Cabinet to submit the final accounts of the State earlier, the Board 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 audit results to be further reflected in the budget. Furthermore, the Board has been steadily undertaking audits related to audit requests made by the Diet under the provisions of Article 105 of the Diet Act, and reporting the audit results to the Diet, as well as issuing "Special Reports to the Diet and the Cabinet" on an as-needed basis every year for the purpose of contributing to enhancement of the Diet's deliberations of the final accounts of the State.

In this way, achievement of fiscal soundness has become an important issue. Moreover, as importance is placed on the strict assessment and verification of the result of the State budget execution as well as the Government's thorough fulfillment of accountability to the people, the role of the Board has taken on more importance, and public expectations regarding audit functions have grown.

3. Basic Policy on Audit

The Board has been striving to conduct audits in order to adequately respond to public expectations in the light of social and economic trends at all times. Under the situation mentioned about, 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 in accordance with the following policies.

(1) Focus of audit

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

- (a) Social security
- (b) Education, Science and Technology
- (c) Public works
- (d) Defense
- (e) Agriculture, Forestry and Fisheries
- (f) Environmental protection
- (g) Information Technology (IT)
- (h) Economic cooperation
- (i) Small and medium enterprises

In addition, the Board enhances cross-cutting audits on policies jointly executed by several ministries and agencies and the cases commonly related with several ministries and agencies, and, if necessary, also responds to matters of much social concern, in a timely and proper manner.

(2) Audit from various audit aspects

The Board conducts audits not only to identify and disclose inappropriate or improper cases but also to evaluate performance. Moreover, the Board conducts audits with a view to the necessity of specific administrative systems, if necessary.

The Board has conducted audits from the following aspects:

- (a) Aspect of accuracy: whether or not the statements of accounts accurately reflect the financial status such as the execution of the budgets
- (b) Aspect of regularity: whether or not the financial transactions are properly processed in conformity with the approved budgets, laws and regulations
- (c) Aspect of economy: whether or not the implementation of projects and programs or budget execution is administered with the minimum cost
- (d) Aspect of efficiency: whether or not the projects and programs gain the maximum result with the given cost or have the best cost-efficient outcome
- (e) Aspect of effectiveness: whether or not the projects and programs achieve the intended objectives and produce the expected effects
- (f) Other aspects necessary for auditing

The Board continues to adequately conduct audits from the aspects of accuracy and regularity, more carefully examining financial transactions in view that inappropriate or improper transactions in

some ministries have been found recently. It also pays enough attention to the competitiveness and transparency of contracts, through examining adequacy of contract methods such as negotiated contracts and reasons for selection of vendors, as well as confirming whether proper procedures for bidding and contracts are taken to secure fair competitive bidding.

Moreover, in light of the serious economic and financial situation in recent years, the Board puts greater importance on the aspects of economy, efficiency, and effectiveness. From the aspect of effectiveness, in particular, the Board actively endeavors to review the results of projects and programs and budgets execution as well as the situation of assets such as funds developed by subsidies and surplus fund. In such cases, the Board conducts audit with attention to auditees' self-evaluation of their policies.

If any problems are found in the implementation of the projects and programs or in the budget execution, the Board thoroughly investigates the causes and considers remedies.

In addition, in order to contribute to the enhancement of the transparency and accountability of administrative and financial operation and the improvement of project implementation, the Board analyzes and evaluates public finances such as final accounts of the expenditures and revenues of the State, and more closely audit the financial status of the special accounts and the independent administrative agencies. Through conducting audit on financial documents of special accounts prepared with reference to practices of corporate accounting, the Board conducts audits with careful attention to issues regarding public sector accounting.

(3) Approach corresponding to conditions of internal control

Since the conditions of internal control influence the adequacy of accounting to be ensured in auditees, the Board pays sufficient attention to their effectiveness. Also, the Board requests the auditees to improve their internal control systems, if necessary, so that they ensure the adequacy of accounting.

(4) Follow-up of the audit findings

The Board continually follows up whether auditees take remedial and preventative measures against improper and irregular cases to ensure that audit results are reflected in the State budget compilation and execution as well as project implementation adequately and effectively.

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

(5) Cooperation with the Diet

The Board always pays attention to the deliberations in the Diet. In auditing issues in response to requests by the Diet, the Board pays full attention to facilitate the Diet's examination and research by including the necessary research contents in the Board's audit activities in adequate consideration of the contents of the Diet's request.

(6) Improvement of audit capability

The board enhances its ability to conduct audits through efforts such as the development of new audit methods to respond to the increasing complexity of society and economics as well as accompanying change in the State's financial and administrative operations.

The efforts include: research studies to vary the methods and scopes of audit activities, human

resource development for auditing areas of expertise as well as recruitment of personnel who have acquired practical skills and experts from private sector, promoting the use of IT in audit activities and utilization of devices for the operation. By adopting these practices, the Board conducts a full and thorough audit for not only accounting but also other related project/program matters as a whole.

4. Designing an Appropriate Audit Plan

The Board designs appropriate audit plans and carries them out to effectively and efficiently achieve its mission, based on this Basic Policy on Audit.

In the audit plans, 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 budgets of auditees, projects and programs, the situations of internal control such as internal audits and internal checks, the previous audit and results, etc..

Also, in auditing, the Board attempts to enhance and strengthen audit activities by flexibly responding to the progress status of audit as well as the public's interest.