

## I Outline of audit activities

### Basic Policy on Audit for 2012

Approved by the Audit  
Commission on  
September 9, 2011

To carry out audits for the year 2012 efficiently and effectively and perform its missions accurately in keeping with social and economic trends, the Board of Audit established its Basic Policy on Audit Activities for the year 2012 as follows:

#### 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.

In addition, because the Great East Japan Earthquake (the earthquake and tsunami that occurred along the Pacific Ocean coast in the Tohoku Region in March 11, 2011, and the resultant accident at a nuclear power plant; hereinafter referred to as the "Great Earthquake") caused serious damage mainly in the Tohoku Region, the restoration and reconstruction of the disaster stricken areas has become an imminent issue for Japan, the public administrations are 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 667 trillion yen at the end of FY2011. In the budget for FY2011, the level of dependence on public bonds is about 47% and the total expenditure required for redemption of national debts comprises about 23% of the general account expenditure, which imposes a major challenge in achieving sound fiscal position. Furthermore, the supplementary budgets for FY2011 have been approved to promote the restoration and reconstruction from the Great Earthquake and it is expected that allocating much more budgets to the restoration and reconstruction will be also needed in the future.

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 since the Audit Report for FY2003, 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. When carrying out audits, the Board will appropriately take into consideration the effects of the Great Earthquake Disaster on the auditees.

#### **(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.

- Social security
- Public works
- Education, Science and Technology
- Defense
- Agriculture, Forestry and Fisheries
- Environmental protection
- Small and medium enterprises
- Economic cooperation
- Information Technology (IT)

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.

Besides, the Board timely and appropriately audits various measures taken for promoting the restoration and reconstruction from the Great Earthquake, taking into account that a large amount of State government expenditure is to be committed in certain period of time with due care that urgent implementation of each project is required. The Board will agilely and flexibly conduct audits according to the situation, closely observing the State government's policies, trends and the conditions in the disaster-stricken areas.

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

Because there are still many improper cases found, the Board continues to adequately conduct audits from the aspects of accuracy and regularity. When conducting audits from these aspects, the Board will examine financial transactions more carefully 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 contractors, 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, 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 makes every effort to facilitate the Diet's examination and investigation by including the necessary research contents in the Board's audit activities, paying full attention to the intention 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 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 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 promptly and flexibly responding to the progress status of audit as well as the public's interest.