

CHAPTER OUTLINE OF AUDIT ACTIVITIES

Section 1. Audit Policies

The Board of Audit established its Basic Policy on Audit Activities for the year 2006 as follows:

Basic Policy on Audit Activities for 2006

(As established on September 2, 2005, Partially revised on November 7, 2005)

1. Mission of the Board of Audit

The Board of Audit has a statutory mission as a constitutional organization independent of the Cabinet. That is, the Board shall audit the final accounts of revenues and expenditures of the State and also such accounts as are provided for by the Board of Audit Law. Through constantly conducting audits, the Board shall monitor the public accounts to secure their adequacy and to rectify defects from the viewpoint of financial control. The Board shall certify the final accounts of revenues and expenditures of the State and shall submit the results of the audit in the form of an annual Audit Report to the Diet through the Cabinet.

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

(1) Japan's Social and Economic Movements 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 spread of innovative information technology and 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 538 trillion yen at the end of FY2005. The total expenditure required for redemption of the national debt and payment of the interest account is 18.4 trillion yen in the budget for FY2005, and comprises about one-fifth of General Account expenditures, which imposes a major challenge on the government and the general public with regard to reducing the national debt and returning to a 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 clear specification of performance objectives and strict post-evaluations that are reflected in budgets, implementation of policy evaluations and evaluations of independent administrative organs, and various studies concerning public accounting, such as preparation of financial statements that introduce corporate accounting concepts.

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 account settlement earlier, the Board of Audit submitted its audit report for FY2003 earlier than previous years, which helped the Diet examine the settlement of accounts earlier and enabled the Diet to further reflect the audit results in the budget. Furthermore, based on the provision of Article 105 of the Diet Law, in June 2005 the Board received 9 audit requests by the House of Councilors so that the House could study the accounting of central government finances. Under this situation, the Board of Audit Law was amended in November 2005 to strengthen and utilize audit activity functions and to help enhance the Diet's examinations of account settlement, such as the expansion of the organs and items subject to selective audit, the obligation to comply with field audits and the reporting to the Diet and Cabinet at any time.

As a result, restoring sound fiscal administration has become 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 accountability, and public expectations regarding audit activities functions have grown.

3. Basic Policy on Audit Activities

The Board has been trying to conduct audits that are oriented towards performance evaluation so that it can adequately respond to public expectations as well as to the social and economic situation at all times. In short, the Board pays constant attention to the general public's interests as well as deliberations in the Diet and makes 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 auditing 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 midsize enterprises
- (h) Environmental protection
- (i) Information technology (IT)

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 requests from the Diet and 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 conducts audits from the following viewpoints.

- Aspect of Accuracy -

Whether or not the statements of accounts accurately reflect the execution of the budgets.

- Aspect of Regularity-

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

-Aspect of Economy and Efficiency-

Whether or not the projects and programs were administered economically and efficiently.

-Aspect of Effectiveness-

Whether or not the project achieved the planned goals and the produced intended effects.

-Other Audit aspect-

The Board will conduct audits from the audit 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. Moreover, in the light of the serious economic and financial conditions in recent years, the Board will put greater importance on the viewpoints of economy, efficiency and effectiveness. From the viewpoint of effectiveness in particular, the Board will endeavor to review the results of programs and budgets actively. In such cases, the Board conducts audit with attention to auditee agencies' self- evaluation of their policies. If there is any problem, the Board will thoroughly investigate the causes and consider remedies.

In addition, to contribute to the improvement of the administration's transparency and accountability, the Board will analyze and evaluate the auditee agencies' financial statements and more closely investigate the financial conditions of the special accounts and the

independent administrative agencies. In response to the new approach such as introducing of the idea of public accounts, the Board conducts audit with careful attentions to problems regarding public accounts.

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

Auditing not only systems of internal control but also whether or not these systems are functional and effective, the Board ensures the effectiveness of the internal control for the adequacy of public accounts by requesting the auditee's improvement of internal control system, if necessary.

(4) Follow up of the Audit findings

To ensure that the results of audit should be reflected adequately in the drafting and execution of budget and political measure, the Board follows up the situations thereafter timely and properly.

Moreover, based on the audit findings in the Annual Audit Report, the Board conducts necessary audits 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 audit methodologies 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 audit methodologies and audit areas
- (2) fostering the auditors who have the ability to audit on the specialized areas
- (3) promoting IT in the audit activities and
- (4) utilizing the audit tools.

4. Designing Appropriate Audit Plan

It is very important to design and carry out an appropriate annual audit plan that aims to effectively and efficiently accomplish our missions, based on the above mentioned Basic Policy on Audit Activities.

When designing an audit plan, it is necessary to determine what to place importance on during audit, taking into full consideration the auditees, the size and content of the measures, affairs and projects, the conditions for internal control such as internal checks and audit, and the results of the previous audit.

Section 2. Audit Implementation

[Coverage]

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

Monthly accounts of revenues and expenditures of the State

Acceptance and distribution of cash and goods owned by the State, and State properties

Charge and collection of government claims and issuance and repayment of Government bonds and other obligation of the State

Acceptance and distribution of cash, precious metals and securities by the Bank of Japan on behalf of the State

The accounts of juridical persons more than half of whose capital is invested by the State

The account to be subject to audit by the Board of Audit in accordance with a provision of any law

In addition, based on the provisions of Article 23, Section 1 of the Board of Audit Law, the Board may audit the following public accounts when the Board has determined it to be necessary or at the request of the Cabinet.

Securities which are owned or taken custody by the State, and cash and goods taken custody of by the State

Acceptance and distribution of cash, goods and securities by entities other than the State, on behalf of the State

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

The accounts of bodies a part of whose capital is invested by the State

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 or

The accounts of bodies for which the State guarantees payment of the principal of or the interest of debt

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 under the provision of
(in regard to the contracts concerned)

In addition to the State accounts, accounts audited for 2006 (auditing period: October 2005 through September 2006) were the accounts of 247 juridical persons including government financial institutions, public corporations and independent administrative agencies as categorized in , the account of Nippon Hoso Kyokai (NHK) as categorized in , the accounts of 4,669 public corporations as categorized in , the accounts of 4 juridical persons as categorized in and the accounts of 13 juridical persons as categorized in .

[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 with the vouchers and other supporting documents, which are submitted from the auditees in accordance with the Regulations for the Verification of Accounts enacted by the Board. While statements show the numeric results of accounting transactions, the vouchers and other supporting documents including, but not limited to, contract documents, invoices and receipts help verify that the statement is accurate, legal and reasonable.

On the other hand, field audit is conducted by dispatching auditors to the offices of auditees to check relevant account books and other necessary documents for reviewing the real implementation of programs and to ask relevant officers for the explanation on the programs.

Actual results of the audit conducted by using above-mentioned two methods in the year 2005 are as follows.

- (a) In-office documentary audit covered more than 170 thousand statements and 52,600 thousand sheets of vouchers and supporting documents for the fiscal 2005.
- (b) Field audit covered more than 2,700 accounting units among the 33,000 auditees and also covered the above 4,669 bodies granted subsidies or other financial assistance by the State. The Board spent 39,300 person-days for the field audit.

Types of auditee offices	Number of offices to be audited (A)	Number of offices actually audited (B)	Audit ratio (%) (B/A)
Head offices of ministries and agencies	4,414	1,977	44.7
Prefectural offices and branch offices	7,997	670	8.3
(Subtotal)	12,411	2,647	21.3
Railway stations and post offices	20,678	138	0.6
(Total)	33,089	2,785	8.4

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 700 inquiry letters were sent relating to the audit conducted in 2006.