

I Outline of audit activities

Basic Policy on Audit for 2010 (Excerpt)

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(As established on September 4, 2009)

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 revenues and expenditures of the State every year and also such accounts as are provided for by the Board of Audit Act.

The Board shall constantly conduct audits and supervise 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 prepare and send 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 society and economy has faced difficult issues, 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. Therefore, the administration systems that have supported Japan's society and economy should respond to these changes.

As for the fiscal position of the State government, when continual issuance of government bonds is steadily increasing the outstanding balance, the government has further issued bonds for a series of economic measures to cope with the worsening economic and financial conditions. As a result, the outstanding balance of government bonds is estimated to reach about 592 trillion yen at the end of FY2009. The expenditure required for redemption of the national debt is about 20.3 trillion yen in the budget for FY2009, and comprises about 20% of General Account expenditures, which imposes a major challenge on the sound fiscal position.

In addition, the Government is planning to carry out reforms in the economic, financial, administrative, and other fields.

(2) Situation Surrounding the Board

In recent years, to make the economic growth and the social security system sustainable, various administrative measures have been carried out for making the State and local governments' basic revenues and expenditures in the black within the next decade. For the above-mentioned purpose, the measures include those for securing stable financial resources through focused and efficient budget allocation, promotion of administrative reforms, thorough elimination of wastefulness, and consideration of drastic reform of the tax system.

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, since the Board has recently been receiving audit requests by the Diet under the provisions of Article 105 of the Diet Law, the Board 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 Act was amended in November 2005 for "Special Reports to the Diet and the Cabinet". As a result, the Board has submitted the Special Reports to the Diet and the Cabinet on an as-needed basis every year.

In this way, achievement of fiscal soundness has become an important issue. Moreover, as importance is placed on the Government's thorough performance 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

(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 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) Small and medium enterprises
- (g) Economic cooperation
- (h) Environmental protection
- (i) Information Technology (IT)

In addition, the Board enhances crossover audits on policies jointly executed by several ministries and agencies and 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 focus on the necessity of the administrative systems itself, if necessary.

The Board will adequately conduct audits from the aspects of accuracy and regularity, more carefully examining accounting transactions in view that inappropriate or improper transactions in some ministries have been found recently, and will pay attention to the competitiveness and the transparency of contracts, through examining propriety of contract methods such as negotiated contracts and adequacy of the reasons for selection of vendors and 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 of 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 actively endeavor to review the results of projects and programs and budget execution as well as assets of funds developed by subsidies. 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 remedies.

In addition, to contribute to the improvement of the transparency and accountability of administration and project implementation, the Board will analyze and evaluate public finances 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 documents of special accounts, prepared with reference to practices of corporate accounting, the Board conducts audit with careful attention to problems regarding public accounts.

(3) Approach corresponding to conditions of internal control

Since the conditions of internal control such as internal audits and internal checks, etc. influence the fair presentation 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 fair presentation 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 project implementation adequately and effectively.

Moreover, concerning 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. 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.

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 the above-mentioned 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, measures, 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.