Ministry of Higher Education and Scientific Research

University of Djilali Bounaama Khmis Miliana

FINANCE AND ACCOUNTING DEPARTMENT

LEVEL: 3RD YEAR ALL THE GROUPS.
MISS: NEDJMAOUI HAMIDA

Lesson 01:

International trade

International trade, economic transactions that are made between countries. Among the items commonly traded are consumer goods, such as television sets and clothing; capital goods, such as machinery; and raw materials and food. Other transactions involve services, such as travel services and payments for foreign patents. International trade transactions are facilitated by international financial payments, in which the private banking system and the central banks of the trading nations play important roles.

Historical overview

The barter of goods or services among different peoples is an age-old practice, probably as old as human history. International trade, however, refers specifically to an exchange between members of different nations, and accounts and explanations of such trade begin only with the rise of the modern nation-state at the close of the European Middle Ages. As political thinkers and philosophers began to examine the nature and function of the nation, trade with other countries became a particular topic of their inquiry. It is, accordingly, no surprise to find one of the earliest attempts to describe the function of international trade within that highly nationalistic body of thought now known as mercantilism.

Mercantilism

Mercantilist analysis, which reached the peak of its influence upon European thought in the 16th and 17th centuries, focused directly upon the welfare of the nation. It insisted that the acquisition of wealth, particularly wealth in the form of gold, was of paramount importance for national policy. Mercantilists took the virtues of gold almost as an article of faith; consequently, they never sought to explain adequately why the pursuit of gold deserved such a high priority in their economic plans.

Mercantilism was based on the conviction that national interests are inevitably in conflict that one nation can increase its trade only at the expense of other nations. Thus, governments were led to impose price and wage controls, foster national industries, promote exports of finished goods and imports of raw materials, while at the same time limiting the exports of raw materials and the imports of finished goods. The state endeavored to provide its citizens with a monopoly of the resources and trade outlets of its colonies.

The trade policy dictated by mercantilist philosophy was accordingly simple: encourage exports, discourage imports, and take the proceeds of the resulting export surplus in gold. Mercantilists' ideas often were intellectually shallow, and indeed their trade policy may have been little more than a rationalization of the interests of a rising merchant class that wanted wider markets—hence the emphasis on expanding exports—coupled with protection against competition in the form of imported goods.

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Liberalism

A strong reaction against mercantilist attitudes began to take shape toward the middle of the 18th century. In France, the economists known as Physiocrats demanded liberty of production and trade. In England, economist Adam Smith demonstrated in his book *The Wealth of Nations* (1776) the advantages of removing trade restrictions. Economists and businessmen voiced their opposition to excessively high and often prohibitive customs duties and urged the negotiation of trade agreements with foreign powers. This change in attitudes led to the signing of a number of agreements embodying the new liberal ideas about trade, among them the Anglo-French Treaty of 1786, which ended what had been an economic war between the two countries.

After Adam Smith, the basic tenets of mercantilism were no longer considered defensible. This did not, however, mean that nations abandoned all mercantilist policies. Restrictive economic policies were now justified by the claim that, up to a certain point, the government should keep foreign merchandise off the domestic market in order to shelter national production from outside competition. To this end, customs levies were introduced in increasing number, replacing outright bans on imports, which became less and less frequent.

In the middle of the 19th century, a protective customs policy effectively sheltered many national economies from outside competition. The

French tariff of 1860, for example, charged extremely high rates on British products: 60 percent on pig iron; 40 to 50 percent on machinery; and 600 to 800 percent on woolen blankets. Transport costs between the two countries provided further protection.

Technology

Technological development can also provide a distinctive trade advantage. The relatively advanced countries—particularly the United States, Japan, and those of western Europe—have been the principal exporters of high-technology products such as computers and precision machinery.

One important aspect of technology is that it can change rapidly. This is perhaps most obvious in the computer field, where productivity has increased and costs have fallen sharply since the early 1960s. Such rapid changes present several challenges. For countries that are not in the front rank, it raises the question of whether they should import high-technology products or attempt to enter the circle of the most advanced nations. For the countries that have held the technological lead in the past, there is always the possibility that they will be overtaken by newcomers. This occurred in the second half of the 20th century when Japan advanced technologically in its automobile production to the point where it could challenge the automobile leadership of North_America and Europe. Japan quickly became the world's foremost producer of automobiles, and, by the early 21st century, Korean automakers were following the Japanese example with the aggressive export of automobiles.

Technological advances also strengthen global trade in a general sense (electronic for example, reduced the impact of geographic distance by facilitating fast, efficient, real-time ties between businesses and individuals around the world. Indeed, at the end of the 20th century, information technology, an industry that scarcely existed 20 years earlier, exceeded the combined world trade in agriculture, automobiles, and textiles.

EXAMPLES OF INTERNATIONAL BUSINESSES

International businesses must have resilient, adaptable, communicative, and resourceful employees who know when to seize expansion opportunities. They need to have a deep understanding of international economics to anticipate how global markets will affect their bottom line and international marketing to effectively communicate their organization's value to diverse audiences.

Here’s a look at five well-known international businesses that have successfully—and not so successfully—navigated the global market.

1. Apple

Apple Inc., founded by Steve Jobs, Steve Wozniak, and Ronald Wayne in the 1970s, is now considered one of the most influential international companies. Headquartered in the United States, Apple designs, develops, and sells electronics, software, streaming, and online services worldwide.

Apple opened its first international location in Tokyo, Japan, in 2003 after saturating the American market. Under Jobs, Apple touted ease-of-use, innovative design, and customer loyalty with the marketing slogan, “Think Different,” and it continues to use visionary strategic marketing and a tight ecosystem to overcome competition and attract creative audiences around the globe.

Apple not only sells products internationally but has supply chains from 43 countries that ship supplies to China for final production and assembly. By keeping a tight-knit and strong relationship with suppliers, strategic inventory, and a focus on sustainability, Apple stands as one of the world’s most successful companies.

2. Financial Times

The Financial Times is a formerly British daily newspaper that’s now owned by the Japanese holding company Nikkei. The Financial Times’ mission is to deliver unbiased, informed investment and economic information to empower individuals and companies to make secure investment decisions.

The Financial Times had a rocky start trying to break into the international market. Andrew Gilchrist, former managing director of the Financial Times, describes his experience at the publication in the online course Global Business.

During his tenure, the Financial Times prioritized entering the international market in India. Despite a large English-speaking population and strong government support, domestic journalism was considered culturally and legally suspect. In fact, the Financial Times was eventually tied up in legal knots because the local newspaper barons were able to challenge every move through the courts.

Eventually, the Financial Times' attempt to go international in India led to an economic slowdown and sluggish company growth.

3. McDonald's

Two brothers, Maurice and Richard McDonald, converted their drive-through barbecue restaurant in San Bernardino, California, into a burger and milkshake restaurant—now known as McDonald's—in 1948.

The McDonald brothers focused on creating a better business system geared toward self-service and efficient and repeatable processes that relied on heating lamps instead of waiters. This model, known as "Speedee," led to lower costs, cheaper products, and faster growth. It became the epitome of "fast food."

Soon after, Ray Croc took McDonald's a step further by bringing in franchisees and suppliers, leading to the creation of restaurants across the United States. McDonald's model continued to expand, and, in 1967, the company opened locations in Canada and Puerto Rico.

McDonald's has been internationally successful, thanks in large part to the consistency its business model allows. The fact that a Big Mac tastes the same regardless of which country you order it in is a testament to the company's long history. Today, there are 38,000 restaurants in more than 120 countries.

4. Coca-Cola

Coca-Cola was created by pharmacist John Pemberton in 1886 at a soda fountain in Atlanta, Georgia. It was used as a tonic for common ailments due, in part, to the addition of cocaine and caffeine derived from the kola nut, which was a major ingredient at the time. (This was later removed from the recipe in 1903.)

Although popular at its inception, Coca-Cola became the company it is today because of the marketing and business leadership of Asa Griggs Candler and future investors, who dramatically increased sales and expanded syrup factory production into Canada.

Eventually, an independent bottle company licensed the rights to Coca-Cola's syrup production and distribution, streamlining production and generating massive profits. Coca-Cola later remarketed for Germany, China, and India, and it's now sold everywhere except Cuba and North Korea.

Coca-Cola currently has over 900 bottling and manufacturing facilities worldwide, many of which are in North America, Asia, and Africa.

5. H-E-B

H-E-B is a popular American grocery company with more than 340 stores in Texas and northeast Mexico. It was founded by Florence Butt in 1905 and expanded into Mexico in 1997.

The primary driver of international expansion wasn't a desire to capture greater market share, but rather, a desire to gain access to foreign produce markets in warmer climates, from which the company could source produce during its domestic suppliers' off-season in the northeastern United States.

Craig Boyan, president of H-E-B, explains in Global Business that, upon becoming an international business, H-E-B bought blueberries from Chile and Peru to sell year-round. Despite it being expensive to ship blueberry crates to Texas, this enabled the company to continue meeting its customers' needs. Since then, production has increased with demand, especially in Mexico, which has an ideal climate to produce blueberries year-round. H-E-B now sources blueberries mostly from Mexico, making them more available and affordable for customers.

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Lesson 02:

Challenges facing the accountants and auditors today

Remarks by Ms Susan Schmidt Bies, Member of the Board of Governors of the US Federal Reserve System, to the Cincinnati Chapter of the Ohio Society of Certified Public Accountants, Cincinnati, Ohio, 28 September 2004.

Introduction

Those of you who are new to the profession no doubt realize, just as your more experienced colleagues do, that you are entering into this noble area of service during a dynamic and crucial time in its existence.. In addition, as the world of commerce and business continues to change, it is vital that the accounting profession responds to meet the challenges of auditing new innovations. I will share some of my views on the challenges that the profession faces today, particularly with regard to accounting and auditing in service industries and model-based accounting.

Accounting in a service based economy

the nearly all of us, first learned about accounting from the “old economy” perspective of retail and manufacturing, we learned that assets and liabilities were valued on a historical cost basis and that the earnings cycle was completed when sales occurred. Indeed, we learned the fundamental concept that revenue was recognized only when it was earned.

Today, our economy is becoming more and more service-based. In the case of services, once the sale has closed, revenues are earned over the ensuing period in which such services are rendered. If earnings are recorded at the time of the sale, that is at the beginning of the service process or before risks are transferred, the financial statements may not be reflecting the earnings process. You may recall that the practice of recognizing revenue “up front” was used by some high-tech firms a few years ago, sometimes in inappropriate circumstances.

One major industry affected by these concepts is the financial services industry. While a small amount of revenue is received for transactions, most is generated by sales that lead to future revenue streams. In the context of the financial services industry, the accounting practice used today is sometimes called the “mixed attribute” approach. This means that some assets and liabilities continue to be recorded on a historical cost basis, while others are reported at fair value or at lower-of-cost-or-market. In some instances in the mixed attribute approach, changes in fair value are reported in earnings, while in other cases they are excluded from earnings but affect the equity portion of the balance sheet. For example, assets that are included in the trading account are carried at fair value and changes in fair value are reported in earnings during the period. Loans that are held-for-sale are separately reported on the balance sheet and recorded, while loans that a bank intends to hold for the long-term are reported at amortized cost.

The success of a trading account as a business reflects management's ability to identify unusual valuations in the market and quickly act upon them. Here, the floating rate means that changes in market interest rates will not affect the fair value of the loan. Rather, credit quality and the cost to service the loan are the two major drivers of profitability. Management's ability to underwrite the credit initially, manage changes in credit risk over the life of the loan, and limit losses of principal and interest and collection costs should a default occur, are key drivers of credit costs. In addition, the costs to receive and post payments and service the loan over its life are important drivers of the operating costs of making the loan.

In this case of loans made to be held in portfolio, amortized cost is appropriate accounting. The interest received over the life of the loan supports the operating costs to service the loan that are incurred while it is outstanding, as well as credit losses that occur, and the cost to acquire funding for the loan. To the user of financial statements, amortized yield, operating costs, funding costs, and credit quality each need to be visible to the user of financial statements, and be reflected in the period in which they are earned or incurred.

Fair value accounting and auditing

While historical cost accounting methods have well-developed auditing techniques, fair value accounting relies on key assumptions, modeling techniques and judgment. The present value of the estimated future net cash flows of servicing assets attempts to anticipate prepayments of mortgages due to changing interest rates, fees earned from late payments, cost to receive payments and remit funds to investors, costs to handle delinquent and charged-off loans and other factors. Since sales of servicing assets, especially for seasoned loans, is so irregular, it is often difficult to validate the model against actual

values seen in the market. Thus, auditing model-based accounting requires a high level of specialized knowledge. The auditor must fully understand how modeling or other sophisticated techniques are used to determine fair value, and whether the assumptions used in the models are appropriate, and that the data has integrity. Accountants are being asked to know more than just the proper classification of assets and liabilities, but also the appropriate way to value assets and liabilities. However, we believe that the accounting industry should be very careful before moving toward a comprehensive fair value approach, where all assets and liabilities are recorded on the balance sheet at fair value and changes in fair value are recorded in earnings, whether or not realized.

In today's world, developing verifiable and auditable fair value estimates is a major concern. The lack of observable market prices, differences in modeling assumptions, expectations of future events and market conditions, as well as customer behavior make the task of assigning appropriate valuations very difficult. And because fair value models are forward looking, the auditor has an additional challenge of determining the line between normal variability in expectations that surrounds any forecast and earnings manipulation.

Financial Accounting Standards Board has recently issued an exposure draft on fair value measurement. The initial phase is generally intended to apply to financial and nonfinancial assets and liabilities that are currently subject to fair value measurement and disclosure. It is not intended to expand the use of fair value measurements in financial statements at the present time. In our view, the proposal is a good first step in enhancing fair value measurement guidance.

Transparent disclosure

These concerns raise the importance of disclosures in the financial statements that assist readers in understanding how the financial statements reflect the business strategy, risk management, and operating effectiveness of the enterprise. As organizations have grown in size and scope, innovative financing techniques have made it more difficult for outside investors to understand a particular firm's risk profile and the performance of its various lines of business.

The improvements in technology, the quick pace of financial innovation, and the evolving risk-management techniques enable businesses to use almost limitless configurations of products and services and sophisticated financial structures. These developments represent significant challenges to standard setters and to accounting firms. For market discipline to be effective, accounting standards and disclosures must evolve to accurately capture these developments.

Challenges for auditors

Auditing firms are facing the growing challenge to build and pass along the knowledge possessed by their professionals who truly understand the audit and accounting issues around particular business lines. As companies broaden the range of products, services, and delivery channels they offer, clients require more specialized knowledge for each operation. As we are all aware, there are fewer large accounting firms competing in the marketplace today. I understand that many of the larger accounting firms are no longer accepting audit engagements of some smaller or medium-sized companies.

This opens an opportunity for small to medium-sized auditing firms to become specialists - so-called “niche players.” In this way, smaller auditing firms can develop the expertise of their auditing staff around the accounting and business practices of the specialized industries or particular types of clients, as knowledge-sharing can be more successful when it is naturally more targeted. Thus, sound judgment is becoming a more valuable talent to businesses and their auditors. One of most important missions is to reinvigorate the profession to successfully address these conflicting goals.

Other challenges

Let me also mention an area that places increased responsibility on auditors. I mentioned earlier the PCAOB. The PCAOB was created through the Sarbanes-Oxley Act to oversee the auditors of public companies. The PCAOB has recently approved Auditing Standard No. 2, An Audit of Internal Control over Financial Reporting Conducted in Conjunction with an Audit of Financial Statements. The new standard highlights the benefits of strong internal controls over financial reporting and furthers the objectives of Sarbanes-Oxley.

This standard requires external auditors of public companies to evaluate the process that management uses to prepare the company's financial statements. External auditors must gather evidence regarding the design and operations effectiveness of the company's internal controls and determine whether the evidence supports management's assessment of the effectiveness of the company's internal controls. While the new standard allows external auditors to use the work of others, including work performed by internal auditors, it emphasizes that external auditors must perform enough of the testing themselves so that their own work provides the principal evidence for making a determination regarding the company's controls. Based on the work performed, the external auditor must render an opinion as to whether the company's internal control process is effective, which is a relatively high standard.

In addition, as part of its overall assessment of internal controls, the external auditor is expected to evaluate the effectiveness of the audit committee. If the audit committee is deemed to be ineffective, the external auditor is required to report that assessment to the company's board of directors. This new standard will certainly put more demands on external auditors and public companies alike. But in the world of business and financial innovation and growing complexity of firms, these standards should encourage greater reliability of corporate financial statements and therefore, regain the confidence of the public and the trust of financial markets.

Conclusion

In conclusion, I hope my views will give you an opportunity to think about some of the challenges both accountants and auditors face in today's business environment. The accounting industry should be cautious and prudent as it debates the merits of fair value accounting. Accountants and auditors alike must be knowledgeable of the models and assumptions used in determining the fair value of products and services. A models-based approach to valuations must produce results that accountants, auditors, and market participants feel are objective. Standard setters have the daunting task of balancing the need to provide accounting principles that keep pace with financial innovation with the need to promulgate standards that produce accurate, reliable and verifiable results