

April 14, 2009

Via Email

Florence E. Harmon
Acting Secretary,
Securities and Exchange Commission
100 F Street NE
Washington, DC
20549-1090

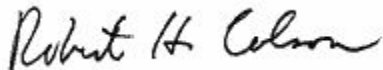
Re: File Number S7-27-08:

**Comments on SEC Proposed Rule on ROADMAP FOR POTENTIAL USE OF
FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) BY U.S. ISSUERS**

The American Accounting Association's Financial Accounting Standards Committee is pleased to express its views in the accompanying document on the SEC's recent call for comments on The Roadmap for adoption of IFRS by U.S. Issuers.

Please contact me (bob.colson@gt.com or 212-624-5300) or Karim Jamal, the principal drafter of the comments, (karim.jamal@ualberta.ca or 780-492-5829) for clarifications or discussion.

Sincerely,



Robert H. Colson

Chair, AAA Financial Accounting Standards Committee 2008 - 2009

This comment was developed by American Accounting Association's Financial Accounting Standards Committee and does not represent an official position of the American Accounting Association.

ROADMAP FOR POTENTIAL USE OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) BY U.S. ISSUERS

Re: File Number S7-27-08

**American Accounting Association's
Financial Accounting Standards Committee
April 14, 2009**

INTRODUCTION

The Securities and Exchange Commission (SEC) recently issued a call for comment on a proposal (henceforth the Proposal) on a roadmap for potential use of International Financial Reporting Standards (henceforth IFRS) by U.S. Issuers. The Financial Accounting Standards Committee (henceforth the Committee) of the American Accounting Association (AAA) is pleased to have an opportunity to express its views on the proposal. This comment was developed by the Financial Accounting Standards Committee of the American Accounting Association and does not represent an official position of the American Accounting Association.

The American Accounting Association promotes worldwide excellence in accounting education, research and practice. Founded in 1916 as the American Association of University Instructors in Accounting, its present name was adopted in 1936. The Association is a voluntary organization of persons interested in accounting education and research. Currently the Association has about 6,000 members in the United States and 2,000 international members. The Committee is charged with commenting on regulatory proposals on financial reporting with an aim to provide a research-based perspective on financial reporting. The AAA's membership has a diverse set of views about financial reporting and the committee does not express views on behalf of all members. On the other hand, the Committee does discuss competing research approaches taken in the academic literature to develop insight into the questions raised in the SEC's Proposal. The Committee's analysis of research has informed its opinions about adoption of IFRS by U.S. issuers, which it hopes will stimulate discussion among AAA members, regulators, and accounting practitioners regarding important financial reporting regulatory proposals.

The SEC's call for comment is a 165 page document that seeks advice on 70 separate issues with respect to the Roadmap for adoption of IFRS by U.S. issuers. Rather than

commenting on each specific issue, we discuss five key issues where extant accounting scholarly research provides relevant insights.

OVERVIEW

The SEC seeks comments on a Roadmap for use of IFRS by U.S. issuers. Current scholarly research provides relevant insights on the following five issues raised in the SEC's proposal:

- (1) Is there a need for a single global set of financial statements (Q1 on p.48 of the proposal)?
- (2) Effect on audit quality and composition of the market for auditors (Q8 on p. 50 of the proposal).
- (3) Views of market participants on resolution of IASB governance and funding issues (Q12 on p. 51 of the proposal).
- (4) Reconciliation to U.S. GAAP from IFRS for comparing companies (Q34-45 on p. 68-78 of the proposal).
- (5) Other issues on which further guidance for IFRS issuers would be necessary and appropriate (Q59 on p. 99 of the proposal).

The remainder of this paper draws upon research and analysis from various academic literatures to conclude the following. First, a single global set of financial reporting standards is not optimal. Robust competition between standard setters is more desirable. In the context of the Proposal, allowing U.S. companies a choice between using U.S. GAAP and IFRS has a higher likelihood of generating high quality financial reporting. Second, the attention devoted to auditing in this proposal is appropriate because accounting standard setters have recently undervalued the importance of verifiability as a qualitative characteristic in setting accounting standards. A major re-alignment between the accounting and auditing standards is necessary for proper implementation of both U.S. GAAP and IFRS. Third, the governance and funding mechanisms of standard setting boards are important for creating independence as well as responsiveness to the needs of preparers and users of accounting reports. The current governance and funding policies of the IASB do not instill confidence in the independence or responsiveness of the IASB. Fourth, requiring reconciliation to U.S. GAAP is costly and unnecessary. The current SEC approach allowing non-U.S. filers to use IFRS without a reconciliation schedule is

also appropriate for U.S. companies. Finally, the cost-benefit analysis fails to consider education implications of the proposed roadmap.

1. Is There a Need for a Single Global Set of Financial Statements? (Q1 on p.48 of the proposal)?

The regulatory debate on the adoption of IFRS is heavily influenced by the objective of obtaining financial statements that are comparable and consistent on a global basis. A single set of high quality global accounting standards is an important mechanism for achieving the desired global comparability and consistency of reported accounting numbers (as discussed on pg 9-18 of the Proposal). This emphasis on comparability and consistency raises two questions: (1) Are comparability and consistency the right goals to pursue, and (2) if they are the right goals, will adoption of one global set of accounting standards help us to achieve the comparability and consistency desired in financial accounting reports? Our view is that comparability and consistency should not be the main goals of financial reporting. Rather, financial reporting should strive for accounting standards that help convey a “true and fair view” of the economic reality of an organization. In addition, academic research indicates that using a single set of uniform accounting standards will not lead to the production of comparable and consistent financial reports that are desirable to regulators (Ball et al., 2000; 2003). The promise that adoption of IFRS will deliver comparability and consistency in accounting reports is false and misleading.

Accounting standards can be regarded as serving two potential functions (see Jamal and Sunder 2008): (1) serving as a minimum quality standard or (2) serving a co-ordination function. Quality standards are motivated by concerns that some producers of a good or service would be motivated to lower quality, especially when quality is not readily observable to the customer. Competition among sellers tends to lower the quality of the output, and in extreme cases, the market can collapse into a “market for lemons” (see Akerlof 1970). In such situations, it may be advantageous to define and enforce minimum quality standards. Quality standards can be ranked in terms of preferability. The extensive discussion, effort and time devoted to the development of U.S. accounting standards can be understood as an investment in determining high quality measurement and disclosure standards.

There is another class of activities where alternatives cannot be rank ordered in terms of quality, but there can still be gains from co-ordinating actions to obtain efficient economic outcomes through uniform behaviour. In many cases, such co-ordination standards can even be arbitrary (e.g., directing traffic flow). The argument for uniformity of accounting as a means of achieving consistency and comparability in financial reports, as well as the attempt to create definitions of assets and liabilities, are examples of co-ordination standards. These standards are justified as being better on co-ordination grounds only, and not on quality considerations.

Comparability and consistency should not be the primary goals of financial reporting. According to a survey by Collins et al., (2002), financial report users perceive a standard to be of especially high quality from an informational perspective when the standard is consistent with an underlying conceptual framework, and the financial report is perceived to reflect economic reality. While there may be some elements of financial reporting that have co-ordination attributes and might even be inherently arbitrary (e.g., accounting for goodwill), all elements of financial reporting do not fit into this category. Appeals to a co-ordination argument (e.g., comparability and consistency) focus on surface level uniformity rather than the underlying economic substance on which the transactions are reported. In the limit, a set of arbitrary conventions could be adopted and regarded as providing comparability and consistency as long as everyone follows the same set of rules (like driving on the same side of the road). Setting up a global monopoly standard setter with a consistency and comparability objective will inhibit attempts to innovate, as well as to develop and test better quality standards. It would represent that triumph of form over substance. Competition between rival standard setters and experimentation with a variety of approaches has the potential to help identify better accounting standards and practices, improve accounting education, and lead to better financial reporting, (Sunder 2002, Benston et al. 2003, Hail et al., 2009).

Even if comparability and consistency were the most desirable goals, adoption of a single set of global financial reporting standards, is neither a necessary, nor a sufficient condition for obtaining these goals. Ball et al (2000, 2003) have examined the influence of accounting standards and other variables in the reporting environment (e.g., legal system, securities enforcement, taxation and incentives of preparers) on the quality of accounting numbers and reports. They use two proxies for quality of accounting reports: (1) Timeliness in reflecting underlying economic income in the financial statements, and (2) Conservatism, which is defined

as the extent to which current period accounting income accelerates the recognition of losses, as opposed to gains. The Ball et al (2000, 2003) studies as well as Bushman and Piotroski (2006) find that the quality of financial reporting in both common law and legal code countries is primarily attributable to incentives of preparers and environmental variables (e.g., legal system, securities enforcement) and not by the adoption of a common set of accounting standards such as IFRS. The conclusion from these studies is that most of the rhetoric surrounding potential gains from adopting a common set of international financial reporting standards (such as IFRS) is incomplete, misleading and unlikely to be realized in practice. A study commissioned by the FASB (Hail et al., 2009) also concludes that the adoption of common accounting standards is unlikely to lead to comparability in financial reporting.

Given vast differences in the underlying assets and economic conditions under which companies operate on a global basis, it is unrealistic to expect that any single set of accounting standards can lead to the production of financial reports that are comparable and consistent in reflecting the actual substance of transactions. The goals of comparability and consistency are slogans that are likely to create an expectation gap between the stated goals of regulators and the reality experienced by preparers and users of financial statements.

We are supportive of the idea of standards competition, that is, allowing U.S. companies to choose between using U.S. GAAP and IFRS rather than only allowing them one choice (U.S. GAAP or IFRS). Competition among accounting standard setters has more potential to improve the quality of financial reporting in the U.S. than reliance on one global monopoly accounting standard setter prescribing a uniform set of reporting standards (Jamal et. al., 2003, 2005). A large literature supports the idea that foreign companies seek to register on U.S. stock exchanges due to the higher regulatory infrastructure in the U.S. (Doidge et. al., 2004). A form of standards competition is currently in place, with foreign companies choosing better regulated jurisdictions such as the U.S. (a race to the top) rather than poorly regulated jurisdictions (the classic boogieman of race to the bottom).

2. Effect on Audit Quality and Composition of the Market for Auditors. (Q8 on p. 50 of the proposal)?

We are pleased with the Proposal's focus on auditing as an important variable that affects the quality of accounting reports. In recent years accounting standard setters (both the Financial

Accounting Standards Board (FASB) in the U.S, and the International Accounting Standards Board (IASB), have reduced their emphasis on using verifiability as a key concept in guiding the development of new accounting standards. The international standards (IFRS) are widely viewed as less specific and providing less prescriptive guidance than U.S. GAAP (i.e., IFRS are more principles based), as well as more subjective primarily due to more use of fair value measurements. The downgrading of verifiability as a key concept guiding accounting standard setting and the resulting focus on fair value measurement significantly impairs the ability of an auditor to limit opportunistic actions of management and improve financial reporting.

There is a widespread belief especially among standard setters that using principles based accounting standards (such as IFRS) leads to better financial reporting than under the more rule-oriented U.S. GAAP system. There is however, virtually no empirical evidence available to support these beliefs. One key problem in this debate about principles versus rules is the lack of a well specified definition of what a rules- based accounting standard is as opposed to a principles-based accounting standard (Schipper 2003). All standards have a conceptual framework, a set of key terms and definitions, and a set of rules. Proposals that declare one specific standard or set of standards to be principle based are mostly ad-hoc, lacking in clear definition (what exactly are the principles of accounting?) and are polemics rather than carefully reasoned arguments. Even if IFRS are more principle based, it is likely that exposure to the litigious U.S. environment may shift them towards a more rule like application (Hail et., al, 2009).

If IFRS are indeed more principle-based, then we should ask what changes will be needed in the auditing profession to create congruency between the shift in accounting and auditing practice. In a recent experiment involving experienced chief financial officers of companies (CFOs) and Big 4 audit firm partners, Jamal and Tan (2008) find that better financial reporting occurs when the standards type (principle-based, rule-based) and the type of auditor (neutral and seeking to reflect the underlying substance of the transaction (principle based), or literal interpreter of the standard - rule-based) are congruent. Lack of congruence between the standards type and the auditor type creates uncertainty, transaction structuring by managers and ultimately poor quality financial reporting. Jamal and Tam do not find a main effect for type of standards. In other words, neither principle-based standards nor rule-based standards always result in better financial reporting. A study by Nelson et al., (2002) also finds no general

advantage for principles-based standards. Their results indicate that auditors find it easier to press management to make adjustments when rules are more specific, but rule specificity also makes the auditor vulnerable to transaction structuring. These results are consistent with the Ball et al (2000, 2003) findings discussed earlier that various elements of the financial reporting environment (legal liability, securities enforcement, auditing) influence the quality of accounting reports produced by companies far more than accounting standards. Adoption of a common set of financial reporting standards will have little effect (and likely a negative effect) if all other variables in the financial reporting environment are not also changed.

After the enactment of the Sarbanes-Oxley Act, many observers—including government regulatory agencies (FASB 2004, SEC 2008)—have raised a concern that the U.S. audit profession is becoming more rule-oriented in response to increased litigation pressures and new guidelines adopted by the Public Company Accounting Oversight Board (PCAOB). This suggests that the adoption of IFRS in the U.S. has the potential to create a mismatch between accounting standards type and auditor type, resulting in poorer financial reporting. The activities of accounting standard setters (FASB, IASB) and auditing standard setters (PCAOB) need to be better coordinated before IFRS is adopted in the U.S.

In many countries around the world (e.g., Canada, Germany), securities regulators allow public companies registered on U.S. stock exchanges the option of reporting domestically using either IFRS or U.S. GAAP. The auditing profession in these countries can develop over time the expertise necessary to support the use of two or more sets of accounting standards. Wholesale adoption of IFRS by all U.S. companies simultaneously will involve a much larger number of companies, and has the potential to be more costly and disruptive than the conversion process in smaller countries (see Collett et al., (2001) for a description of IFRS implementation challenges in Australia).

3. Views of market participants on resolution of IASB governance and funding issues. (Q12 on p. 51 of the proposal)?

Accounting standards in the U.S are developed by the FASB whose budget comes primarily from a tax levied on publicly traded companies in the U.S., with a secondary revenue stream from the sale of publications. This reliance on public funding is conducive to developing the independence of the standard setting board since the board is not dependent on the generosity

of private donors. An alternative model would be to allow competing standard setting boards to charge fees to people who use their standards as is done for ISO standards (e.g., Sunder 2002), or even combine accounting and auditing standard setting in one Board and let private certifiers compete on a bundle of both accounting and auditing standards (see Jamal, Maier and Sunder 2003, 2005 for an example of this approach in e-commerce). Having the current IASB funded by a small number of voluntary contributions received from private organizations (large corporations and big audit firms) is not conducive to developing perceived or actual independence of the standard setting board (Beresford 2001). Clearly some reforms in governance and funding process are necessary for safeguarding the independence of the IASB as well as making it responsive to the needs of preparers, auditors and users of financial reports.

While the current funding system of the IASB is not ideal, it is not necessary to demand an acceptable resolution of all governance and funding issues prior to U.S. adoption of IFRS. . We prefer a partial adoption process where a choice is offered, and may be exercised by some U.S. companies. In the meantime, we suggest that the IASB can modify its governance processes and especially its funding mechanism.

4. Reconciliation of IFRS to U.S. GAAP (Q34-45 on p. 68-78 of the proposal)?

The Proposal focuses considerable space and thought on assessing the need for a reconciliation of IFRS financial reports to U.S. GAAP. Options proposed include one time disclosure only on the initial adoption of IFRS, annual preparation of a reconciliation schedule, and having the reconciliation schedule audited on an annual basis. A large academic literature on the “value relevance” of such reconciliations includes very pointed disagreements about methodology, interpretation, and propriety of this work. Barth et al., (2001) provide a defense of value relevance studies, while Holthausen and Watts (2001) argue that these results are irrelevant for standard setting due to the use of an invalid quality criterion, self-selection problems, concerns about the valuation models used, and a host of methodological concerns. Foreign companies that were required to prepare 20F reconciliation schedules are quite different from domestic U.S. companies. They were large multinational companies (Lang et al., 2003) and so generalizations from these reconciliation schedules to U.S. domestic companies should be made cautiously.

The Committee has responded at length on this reconciliation issue on a previous SEC proposal in September 2007 (SEC S7-13-07) on allowing non U.S. companies to use IFRS without requiring reconciliation to U.S. GAAP. We surveyed various streams of literature, and particularly a paper by Leuz (2003) which finds that financial statements prepared using IFRS are basically equivalent to those produced using U.S. GAAP. This pattern of results is robust and occurs when looking at financial information prepared by specific companies, as well as the overall liquidity, bid-ask spreads and other features of the overall stock market. Based on these results, we supported the previous proposal (SECS7-13-07) to allow non U.S. companies to have a choice between using U.S. GAAP or IFRS to prepare their financial statements without a reconciliation requirement.

We continue to support giving U.S. companies the choice to use IFRS or U.S. GAAP in their U.S. regulatory filings. In our previous response, we cite an extensive literature (e.g., Ashbaugh and Pincus 2001; Leuz 2003) which indicates that IFRS help produce high quality financial reports and that U.S. GAAP and IFRS have an equivalent level of quality, though they are not perfect substitutes for one another. Requiring reconciliation schedules undermines trust among accounting standard setters and makes it more difficult for U.S. standard setters to learn from practices and experience of other countries.

5. Other issues on which further guidance for IFRS issuers would be necessary and appropriate (Q59 on p. 99 of the proposal)?

While the primary criteria for the SEC's decision relate to the direct and immediate impact on capital markets and investor protection, the SEC's regulatory actions and policies have major educational consequences. These educational consequences have the potential to influence the long run quality of students attracted to accounting, the quality of professional judgment of preparers and auditors, and ultimately the quality of financial reporting. The Commission has not solicited comments on educational aspects of its proposed action, but the AAA and its members are deeply interested in accounting education, research, and practice. We would like to submit the following unsolicited comments on the educational consequences of the proposed action, repeating a recommendation made by our committee in 2007 (file SEC S7-13-07) that the Commission and its staff also consider the educational consequences of its proposed

actions as a part of its routine process going forward. We believe such considerations should always be a part of the standard setting process and are particularly important in this instance.

The adoption of IFRS in the U.S. will require a major education effort by current preparers, auditors and investors, as well as accounting students. In our previous comment we suggested that allowing two rival sets of accounting standards might be an excellent way of attracting talented students to accounting, stimulate classroom discussion and better development of professional judgment of accountants and auditors (Sunder 2007, 2009). The consequences of the accounting standard setting regime on accounting education should be considered more explicitly in weighing the costs and benefits of proposed regulatory changes.

Summary and Conclusion

Financial statements based on IFRS provide good financial reports that are equivalent to those based on U.S. GAAP. We favor giving U.S. companies the choice of using U.S. GAAP or IFRS in their financial reports and hope that other jurisdictions around the world would exploit the advantages of giving choice to their own registrants. This will lead to a gradual and partial adoption of IFRS in the U.S. We believe a gradual adoption process will give preparers, auditors, investors and other financial market participant's time to align their processes with IFRS or consciously choose to maintain U.S. GAAP reporting in their financial statements. We do not favor the imposition of a mandatory reconciliation requirement. We view a reconciliation schedule as being costly, of limited value, and counter-productive vis-a-vis the broader goal of developing high quality accounting standards and financial reports. We also strongly recommend that the SEC explicitly consider the educational impact of its future proposals. We are skeptical about creating a monopoly global accounting standard setter and are not convinced that benefits will accrue from the current desire for the harmonization of accounting standards. We recommend that standards competition between U.S. GAAP and IFRS be given more consideration as a mechanism to improve the quality of financial reporting.

American Accounting Association

Financial Accounting Standards Committee 2008 – 2009

Robert Bloomfield, Cornell University (Endorse)

Theodore E. Christensen, Brigham Young University (Endorse)

Robert H. Colson (Chair), Grant Thornton LLP (Endorse)

Karim Jamal (Principal Author), University of Alberta (Endorse)

Stephen Moehrle, University of Missouri at St. Louis (Endorse)

James Ohlson, New York University (Endorse)

Stephen Penman, Columbia University (Endorse)

Gary Previts , (Co-Liason to AAA Executive Committee), Case Western Reserve
University (Endorse)

Thomas Stober (Liaison to Financial Accounting and Reporting Section), University of
Notre Dame (Endorse)

Shyam Sunder, (Co-Liason to AAA Executive Committee),Yale University (Endorse)

Ross L. Watts, Massachusetts Institute of Technology (Endorse)

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