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The Effects of Bank Regulators and External Auditors on Loan Loss Provisions[☆]

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Abstract

I examine whether bank regulators and external auditors have conflicting effects on loan loss provision timeliness, an accounting choice associated with important economic consequences and a potential conflict between regulators and auditors. In the absence of the other group, auditors and strict regulators are each positively associated with timeliness. However, audits are negatively associated with timeliness when strict regulators are present, consistent with a conflict for which auditors are the dominating group as audited banks attain a similar level of timeliness regardless of the extent of regulatory scrutiny. Collectively, this suggests that regulators and auditors differentially influence loan loss provisions.

Keywords: banks; loan loss provisions; bank supervision; auditors

1. Introduction

This paper investigates how the objectives and incentives of bank regulators and external auditors affect loan loss provisions. Both groups examine financial reports during on-site safety and soundness examinations or financial statements audits and serve an important monitoring role given their access to internal bank information. In particular, regulators and auditors spend considerable time evaluating the loan loss provision, although this focus is driven by their different objectives (Balla, Rose and Romero, 2012). For regulators, the loan loss provision focus stems from safety and soundness concerns and the associated macroeconomic consequences, such as bank lending activity and systemic risk (Beatty and Liao, 2011; Bushman and Williams,

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