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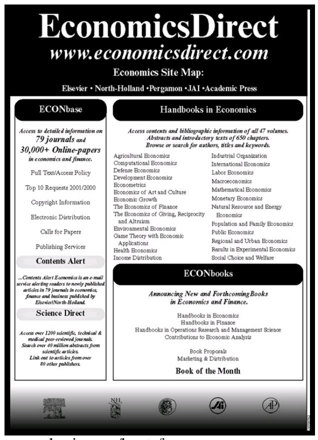

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Does Managerial Sentiment Affect Accrual Estimates? Evidence from the Banking Industry

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Abstract

We examine whether managerial sentiment is associated with errors in accrual estimates. Using public banks we find (1) managerial sentiment is negatively associated with loan loss provision estimates, (2) future charge-offs per dollar of provision are positively associated with sentiment when the provision is estimated, and (3) the effects of sentiment are greater for firms with more uncertain charge-offs. Results are similar for private banks, suggesting accrual manipulation related to capital market incentives is unlikely to explain the results. Although economic fundamentals explain most of the variation in the provision, we find sentiment has an incremental and economically meaningful effect.

Keywords

Sentiment; Earnings quality; Accruals; Loan loss provision, Banking industry

1. Introduction

A growing body of research considers the role of sentiment in financial decisions. In common usage, the term sentiment refers to feelings or beliefs about a situation, state of affairs, or event. Applied in the finance and accounting literature, however, the term sentiment more narrowly depicts beliefs that are *unjustified* based on available information (e.g., Baker and Wurgler 2007). While evidence indicates economic data justify the majority of beliefs about the state of the economy (e.g., Lemmon and Portniaguina 2006), research shows that sentiment has meaningful effects in both asset pricing and corporate decision-making settings. For example, Baker and Wurgler (2006) find sentiment is associated