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*Financial Reporting Quality in Politically
Connected Banks*

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Abstract

This study investigates the relation between banks' political connections and their financial reporting quality. Using a geography-based measure of political connection, we find that politically connected banks have significantly lower financial reporting quality. Specifically, we show that connected banks have higher levels of discretionary loan loss provisions, recognize expected loan losses in a less timely manner, and have loan loss provisions of lower validity. Politically connected banks also have less timely loan charge-offs and they are more likely to manage earnings to avoid earnings declines. We interpret the findings as evidence that moral hazard problems are more severe in politically connected banks and they have stronger incentives to use opaque financial reports to conceal excessive risk taking and facilitate regulatory forbearance. In addition, the market discipline of connected banks is likely lower and thus there is a lesser demand for transparent financial reporting. Our further empirical evidence supports both interpretations. Overall, our results suggest that political connections are a significant determinant of banks' financial reporting quality.

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A Short Biography of Prof. Liandong ZHANG

Prof. Liandong Zhang is Professor of Accounting at School of Accountancy at the Singapore Management University. He joined Singapore Management University in 2017 as the Associate Dean (Research) at School of Accountancy. Prof. Zhang graduated from Tsinghua University, Beijing and received his PhD Degree in Accounting from Nanyang Technological University in 2008. He has previously taught at the Concordia University in Canada and City University of Hong Kong. His current research interests include financial reporting quality, corporate governance, and taxation. He currently teaches Accounting Theory.

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