Regulation, Supervision and Accounting Conservatism: Interaction of the Three Pillars of Basel II to Achieve Quality of Reporting Earnings in Worldwide Banks

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Abstract : Accounting conservatism is a desirable quality of earnings that is positively associated with the stridency of regulatory and supervisory regimen and high market discipline. But how these three pillars interact each other is the main research question that is not empirically solved. We analyze how regulatory and supervisory regimes interact with the market discipline measures, such as listing status, ownership and market concentration using a sample of 14,651 bank-year observations covering 54 countries over the period 1997-2009. We evidence that regulation a supervision and extend on which they are enforcement is a strong mechanism to achieved accounting conservatism in those countries or situations where the market discipline fails. Generally, the supervisory power reinforces the effect of listing status, ownership and concentration on conservatism, while capital regulatory mitigates the effect of market discipline on conservatism. This paper may contribute to debate about the mechanism introduced by Basel III that strongly increases the regulation, his enforcement, and the supervisory power after long deregulation period. Although Market discipline is relevant to achieve the financial stability, strong Pillar I and II can ensure the quality of the accounting earnings to prevent bank failures.

Keywords: accounting conservatism, bank regulation, bank supervision, loan loss recognition, market discipline

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