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Bank Stress Tests and Borrower Non-GAAP Reporting

Abstract

Bank stress testing is a key supervisory exercise affecting the banking industry in the United States. We find that firms are more likely to report non-GAAP earnings after borrowing from banks subject to stress testing. The effect is more pronounced when loan contracts include more earnings-based covenants, when stress-tested banks have greater exposure to the tests, and when firms have higher credit risk. These results are consistent with borrowing firms reporting non-GAAP earnings to increase the credibility of modified earnings in loan contracts and to facilitate public financing. We also find that firms borrowing from stress-tested banks provide higher-quality non-GAAP reporting. In sum, our study shows that changes in bank regulations have a significant impact on firms' non-GAAP reporting decisions.

Biography

Charles Hsu is a Chair Professor at the Department of Accounting, School of Business and Management, Hong Kong University of Science and Technology. He obtained his PhD in accounting from Purdue University. Prof. Hsu's research interests are in corporate disclosure, financial analyst, corporate governance and sustainability. He has published articles in leading accounting and finance journals such as *Journal of Accounting and Economics*, *Journal of Accounting Research*, *The Accounting Review*, *Journal of Finance*, *Contemporary Accounting Research*, *Review of Accounting Studies*, and *Journal of Finance and Quantitative Analysis*. Prof. Hsu has served as editorial board member of *The Accounting Review*, *European Accounting Review*, and *China Journal of Accounting Research*.

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