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Bank earnings management and income smoothing using commission and fee income: A European context

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Purpose

The purpose of this paper is to investigate whether European banks use commission and fee income (CF) to smooth reported earnings or to persistently increase reported earnings as an income-increasing earnings management strategy.

Design/methodology/approach

The author tests the income-smoothing hypothesis following the approach of Stubben (2010) and Ahmed *et al.* (1999).

Findings

The author finds that European banks use CF to smooth reported earnings and this behaviour is pronounced among non-too-big-to-fail (NTBTF) European banks compared to too-big-to-fail (TBTF) European banks. The author also finds a positive and significant correlation between interest income and non-interest income (CF) indicating increased systematic risk due to reduced diversification benefits. The author also finds that the CF of NTBTF banks is procyclical with fluctuating economic conditions but not for TBTF banks. Also, the author finds evidence for income-increasing earnings management in the post-crisis period, for larger European banks and when banks have higher *ex post* interest income, implying that the propensity to engage in income-increasing earnings management significantly depends on bank size and *ex post* interest margin considerations. The findings have policy implications.

Originality/value

The author examines alternative financial numbers that banks use to manage earnings. The author focusses on income smoothing via CF among European banks, a context that has not been explored in the literature.

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