This dissertation focuses on empirically evaluating the economic impact of agency problems in the settings of bank real earnings management and board’s selection of auditors.

In the first essay, I hypothesize and provide evidence that commercial banks manipulate loan origination activities for loan-transfer-based earnings management. Using a unique database that contains home mortgage origination information of all commercial banks in the United States, I find that banks increase the origination of the more liquid non-jumbo mortgages for loan transfer (i.e., loan sale and securitization) to meet earnings benchmarks. To originate more non-jumbo mortgages, I find two strategies are used by the banks: (1) denying fewer applications and (2) attracting more borrowers to accept the approved applications. I also find that the manipulation is negatively associated with both future bank interest income and noninterest income, which suggests that the manipulation has negative long-term consequences.

In the second essay, I study one of the most controversial policies in the public accounting industry - mandatory audit firm rotation. This essay empirically evaluates and quantifies the economic impact of mandatory auditor rotation using a structural approach, focusing on the critical role played by the board in auditor selection. My counterfactual analysis suggests that (1) the cost of a ten-year rotation policy to shareholders is 5.9 billion to 7.2 billion dollars; (2) a significant fraction of the cost results from reduced board effectiveness in selecting desirable auditors and hence the policy is more costly to the shareholders of the firms with strong internal governance; (3) policies that improve firm internal governance can work better and increase shareholder value; and (4) the cost of mandatory rotation becomes even higher when firm internal governance improves and the board interests become fully aligned with shareholder interests. These findings highlight the potential cost of mandatory audit firm rotation and that the proposed rotation may counteract other policies intended to improve internal corporate governance.