Department of Accounting

Fraud Detection and Financial Reporting and Audit Delay

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Abstract

I formulate a model to emphasize the fraud detection role of auditors in the financial market, providing a theoretical framework to understand the determinants of and market reaction to a financial reporting and audit delay. Consistent with SAS 99, the model has an auditor considering whether to perform extended audit procedures, depending on the outcome of regular audit procedures. My result on the market reaction to a delay suggests that while a negative average reaction is intuitive and has been documented empirically, the reaction does not have to be negative for an individual firm. I derive a closed-form condition indicating when a positive market reaction to a delay is possible. This is a new result not previously discussed in the literature. The model's empirical implications are discussed in detail with specifies including suggestions for regression equation specifications. Some of the empirical implications can be related to business ethics education. Thereby the model provides a framework to quantify the potential effect of business ethics education.