

Chapter 15.3

Misrepresentation of trading outcomes

Outline

- Problem and model assumptions
- Incentives for traders
- Incentives for managers
- Equilibrium outcome
- Summary

■ Problem and model assumptions

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Hiding losses and reporting profits

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$$\mathbf{▶} \quad p^* = \frac{(1-\lambda_M^*)(F_T + w_T V_H)C}{(1-\pi)(F_M + w_M V_H)(w_T(V_H - V_L) - \lambda_M^*(F_T + w_T V_H))}$$

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- ▶ Auditing reduces misrepresentations directly, but also reduces **monitoring efforts**

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- ▶ Managers are **complicit** in such behaviour as they benefit, too

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- ▶ The incentives of higher remuneration for managers after misrepresentation lead to limited monitoring, allowing misrepresentations to occur
- ▶ Managers are complicit in such behaviour as they benefit, too



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