Media Optimism and Audit Premium: Inhibition or Enhancement?

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Abstract: Based on positive media reports and the data of A-share listed companies from 2012 to 2021, this paper explores the influence of media optimism on audit premium. The empirical results show that media optimism can significantly increase audit premium, and this effect is more significant in profitable companies with high analyst attention. Further research shows that media optimism will drive the increase of investor sentiment, and investor sentiment plays an intermediary role in the relationship between media optimism and audit premium. It is found that the optimism of the media will not make auditors relax their "vigilance". On the contrary, the high exposure of the media and the upsurge of investor sentiment increase the litigation risk and extra investment of auditors, which is ultimately reflected in the increase of audit premium. The research conclusion provides an incremental explanation for the influencing factors of audit premium and has certain policy implications for how to better play the synergistic role between media and auditor.

Keywords: Media Sentiment; Audit Premium; Investor Sentiment

1. Introduction

For a long time, the media has played the role of a little boy in the capital market to debunk the "Emperor's new clothes". The media's reports on listed companies have become an important link between the capital market and public investors, which also makes the media's attention increasingly become an important external governance mechanism in corporate governance. However, while assuming the role of information supply, media reports sometimes use more powerful language in the description of the report content, which shows the existence of media emotions. These reports with obvious "emotions" will make the news content have obvious bias. This tendency will be transmitted to the capital market as an investment signal, which will profoundly affect the psychological cognition and behavior of investors.

Auditors, who also play an external governance role, as one of the audiences of the news media, will also be affected by media sentiment. The negative sentiment of the media will send a signal of high litigation risk to the auditor. In order to reduce the audit risk to an acceptable low level, the auditor will adjust the audit strategy, expand the audit scope and increase the audit input according to the recognition of widespread public concern, resulting in a higher premium of the audit fee. If the negative emotions of the media will lead to the increase of audit fees, will the auditors be affected by the optimistic emotions of the media when auditing enterprises, which will lead to the abnormal changes of audit fees? However, in the previous literature, few articles have discussed the above issues in depth, and the relationship between media optimism and audit premium needs to be further clarified.

2. Theoretical analysis and research hypothesis

According to the classic audit pricing model proposed by Simunic (1980) in the 1980s, audit fees mainly depend on the scale of the audited entity[1], the complexity of the audit project and the occupational risk undertaken by the auditor. The scale of the auditee and the complexity of the audit project are the cost inputs that can be directly observed by the auditor, while the occupational risk borne by the auditor is the main component of audit premium. Existing studies believe that audit pricing models contain

unobjectionable factors, which will also affect auditors' pricing decisions and are reflected in abnormal audit fees[2]. From the perspective of "cost theory", the excessive abnormal audit fee is the compensation for the extra cost paid by the auditor when undertaking audit business[3]. The audit premium formed by such compensation does not affect the audit quality, on the contrary, the compensation represents the auditor's efforts. The higher the abnormal audit fee is, the higher the auditor's efforts will be. Further improve the accuracy of financial reports[4]. However, more literatures support the view of "rent theory", and believe that abnormal audit expenses are mainly the rent paid by the audited entity in order to buy satisfactory audit opinions. The existence of such rent will seriously affect the auditor's independence and damage the audit quality. In addition, there is a third view that the auditor's cost compensation and rental fees together constitute an audit premium. According to existing research, auditors can adjust the occupational risks they may face by changing pricing decisions. When the media sentiment is optimistic, there will be more positive reports on enterprises, and the public's trust in the operation and development of listed companies will be enhanced based on public information tips. As one of the audiences of the news media, auditors are more inclined to make positive evaluation in the process of risk assessment of enterprises in the face of the audited units with good market performance. Companies can also rely on their good social reputation to improve bargaining power, enabling auditors to adjust pricing decisions and reduce audit premiums. However, the media is not an ideal "opinion leader"[5]. If driven by economic interests, the media cannot be completely independent, they may be willing to report content that is beneficial to enterprises and thus influence investors' analysis and judgment and investment decisions. Scholars have found that market analysts are infected by media optimism and are more inclined to issue positive analysis reports and earnings forecasts. Analysts' optimistic forecasts can lead to a surge in investor sentiment, and if auditors fail to spot the potential risks beneath the "shiny" facade, they risk being "shouted down" by investors and analysts, which means higher litigation risks, forcing auditors to work harder and increasing the audit premium. Based on this, this paper proposes the competitive hypothesis H_{1a} and H_{1b}

H_{1a}: Media optimism is negatively correlated with audit premium, that is, media optimism will inhibit audit premium.

H_{1b}: Media optimism is positively correlated with audit premium, that is, media optimism will increase audit premium.

3. Research design

3.1 Sample selection and data sources

In this paper, A-share listed companies in Shanghai and Shenzhen from 2012 to 2021 are taken as the initial research samples, and on this basis, the following treatments are carried out: (1) The samples of the financial industry are deleted, while ST companies that are specially treated are excluded; (2) Remove research samples with missing relevant data; (3) Eliminate research samples that cannot obtain accurate information due to other problems such as format. In order to avoid estimation bias caused by extreme values, all the continuous variables are also reduced by 1% quartile. Other relevant financial data are derived from the CSMAR database.

3.2 Definition of Variables

3.2.1 Audit Premium

This paper draws on the method proposed by Chen Lihong et al. (2022) to build an audit pricing model[6]. Firstly, the predicted value of audit fee is calculated, and the ABFEE is calculated by subtracting the predicted value from the actual audit fee.

3.2.2 Media optimism

The more positive media coverage, the more optimistic the media mood. The number of positive stories (POS) and the proportion of positive stories to total stories (POSR) for each company in a year were measured to measure media optimism.

3.2.3 Control Variables

With reference to the relevant literature of Simunic (1980) and Chen Lihong et al. (2022), this paper selects control variables from three aspects: corporate financial data, governance level and firm. It specifically controls company size (*SIZE*), asset-liability ratio

(*LEV*), corporate growth (*GROWTH*), business complexity (*SEG*), last year's audit opinion (*LOP*), firm size (*BIG10*), return on equity (*ROE*), audit lag (*TIME*), management shareholding ratio (*MSR*) and institutional investor shareholding Ratio (*INS*).

3.3 Model construction

In order to verify hypothesis H1 in this paper, model (1) is constructed as follows:

$$ABFEE = \beta_0 + \beta_1 POS_{i,t} + \sum \beta_i \times Controls_{i,t} + YEAR + IND + \varepsilon_{i,t} \quad (1)$$

Where, β represents the regression coefficient of each variable, Controls represents the set of control variables, and ε represents the residual term. In addition, we control for YEAR fixed effects (YEAR) and industry fixed effects (IND) and cluster adjusted standard errors at the firm level.

4. Empirical analysis

4.1 Descriptive Statistics

In order to observe the statistical regularity of explained variables and explanatory variables, descriptive statistics were conducted on sample data in this paper, and the results were shown in Table 2. It can be seen that the mean value of audit premium is 0.0246, the maximum value is 1.274, the minimum value is -1.063, the median is 0.0127, and the standard deviation is 0.430, indicating that audit premium is common in listed companies and the amount of premium varies greatly among companies. This result is consistent with the description of existing literature. In addition, the median of POS and POSR proxy variables of media optimism is 0, indicating that optimism of media does not exist in most listed companies, which is also in line with the reality. The other control variables are basically consistent with the descriptive statistical results of the existing studies.

Table 2 Descriptive statistics

Variable	Observed	Average	Sd	Median	Minimum	Maximum
ABFEE	25846	0.0246	0.430	0.0127	-1.063	1.274
POS	25846	0.192	0.480	0	0	2.303
POSR	25846	0.128	0.312	0	0	1
SIZE	25846	22.22	1.293	22.04	18.97	26.07
LEV	25846	0.424	0.206	0.414	0.0503	1.008
GROWTH	25846	0.400	1.083	0.142	-0.746	8.553
SEG	25846	0.265	0.162	0.247	0.00522	0.739
LOP	25846	0.969	0.173	1	0	1
BIG10	25846	0.589	0.492	1	0	1
ROE	25846	0.0489	0.160	0.0666	-0.959	0.373
TIME	25846	99.46	18.04	105	33	120
MSR	25846	13.67	19.55	0.798	0	70.77
INS	25846	42.49	24.53	44.00	0.360	92.29

4.2 Correlation analysis

Before regression, correlations among variables were tested in this paper (omitted due to space limitation). There is a significant positive correlation between media optimism and audit premium, that is, media optimism will increase audit premium. Hypothesis H_1b in this paper is preliminarily verified, but the specific situation needs to be further tested. In addition, VIF test was also conducted in this paper, and the variance inflation factor of each variable was between 1.05 and 2.03, far less than 10, indicating that there was no obvious multicollinearity problem between the selected variables.

4.3 Analysis of regression results

In order to further verify hypothesis H1, Equation (2) is regression performed in this paper, and the results are shown in Table 4. Column (1) and (3) examined the influence of media optimism on audit premium. It can be seen that the regression coefficients of POS and POSR are 0.057 and 0.063 respectively, both of which are significant at the 1% level. Columns (2) and (4) are the regression results after the addition of control variables. The regression coefficients of POS and POSR are still positive and significant at the level of 1%. It indicates that media optimism will force auditors to increase cost input and risk premium, that is, media optimism will increase audit premium. The above findings verify H1b of this paper

Table 2 Regression results of media sentiment and audit premium

variable	(1)	(2)	(3)	(4)
	ABFEE	*ABFEE*	*ABFEE*	*ABFEE*
POS	0.057***	0.047***		
	(6.80)	(5.74)		
POSR			0.063***	0.051***
			(5.66)	(4.58)
CONTROLS	Yes	Yes	Yes	Yes
CONSTANT	0.020***	0.247	0.023***	0.250
	(3.13)	(1.44)	(3.61)	(1.45)
YEAR	Yes	Yes	Yes	Yes
IND	Yes	Yes	Yes	Yes
N	28408	25846	28408	25846
ADJ-R²	0.073	0.081	0.072	0.080
F	46.295	8.662	31.988	7.363

5. Conclusion and Enlightenment

This paper measures media optimism based on positive reports and studies the relationship between media optimism and audit premium. The empirical results show that there is a significant positive relationship between media optimism and audit premium. Specifically, the higher the media optimism, the higher the audit premium. The findings of this paper suggest that the optimism of the media and the "glossy" appearance of companies do not make auditors relaxed, but rather that auditors need to invest more effort to gain a deeper understanding of the financial performance and business activities of the company during the audit process, in order to reduce inspection risks and their own practice risks. The additional input and risk premium leads to the increase in audit premium. As important participants in the capital market, the media and auditors have a lot in common in reducing the risk of investor information and supervising the behavior of management. They should pay attention to the synergy, abide by the professional ethics, and work together to maintain the sound development of the capital market.

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