

Summary of Paper: [Policy Uncertainty and Accounting Quality](#)

What is this Study About?

This study delves into how economic policy uncertainty (EPU) affects accounting quality. Accounting quality is measured based on a model that compares the accruals component introduced to capture true economic performance to the portion representing performance measurement errors. The researchers suggest that during periods of heightened policy uncertainty, investors increase their attention to company-specific information, as the value of such information increases, and uninformed investors cannot easily infer information from the equilibrium price when uncertainty is high. Consequently, this greater scrutiny of company-specific information during high-EPU periods limits earnings management opportunities and motivates managers to improve accounting quality.

What are the major findings of the study?

Using data from 19 countries over the 1990–2015 period, the study finds that accounting quality is higher during periods of elevated EPU. This positive relation is more pronounced for companies with greater dependency on government contracts and those facing higher political risks. The positive impact of EPU on accounting quality extends to other measures of earnings properties. Additional analyses based on institutional investors' trading behavior, media freedom, and press circulation suggest that market participants' attention to company-specific information is a mechanism through which EPU affects accounting quality. The study further finds that while EPU affects investment and valuation negatively, high accounting quality mitigates this adverse effect.

Why is the study important?

By highlighting the influence of policy uncertainty on accounting quality, the researchers provide valuable insights for policymakers, companies, and investors regarding the implications of EPU on financial reporting. This study identifies investors' attention to company-specific information as a critical force in shaping accounting quality during periods of heightened uncertainty. Additionally, the results suggest that improving accounting quality can mitigate the adverse effects of EPU on investment and valuation, underscoring the benefits of high accounting quality during periods of elevated EPU.