

# Accruals vs. deferrals: The case for an income-oriented concept of accruals

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**Abstract:** The dominant current concept of accruals is that, for a given period, accruals are the changes in all non-cash assets and liabilities. This is essentially a “net accruals” perspective on accruals, which emphasizes the summary results of the accrual process on balance sheet positions over a period of time. This paper argues that an income-oriented concept of accruals better captures the essential role of accruals in shifting the recognition of cash flows into accrual income across time, aiming to create a better measure of firm performance than cash income. While the income-oriented concept of accruals is internally consistent with the asset/liability concept, its major advantage is in clarifying the critical distinction between deferrals and accruals proper. Deferrals like the capitalization of PPE defer the recognition of cash flows *away* from the period in which they occur, and have little discretion or estimation. Accruals proper like depreciation expense accrue the effect of the corresponding cash flow *into* preceding or subsequent periods, and can have moderate to extreme discretion and estimation. Establishing this critical distinction brings conceptual clarity about the nature and function of accruals, and helps answer a number of vexing problems in accounting, including whether no-growth firms have accruals, the nature and evolution of the negative correlation between accruals and contemporaneous cash flows, and the distinction between net and gross accruals.

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## **Accruals vs. deferrals: The case for an income-oriented concept of accruals**

### *1. The balance sheet-oriented concept of accruals*

Accruals are the difference between the two dominant systems of accounting, cash and accrual accounting. Thus, the concept of accruals lies at the heart of accounting, and is the key to the understanding of its characteristics. Accordingly, ideas about the nature of accruals have been percolating through accounting theory and practice for hundreds of years or longer. And yet, the dominant current notion of accruals is surprisingly recent, perhaps most clearly traced to the definition and decisive contribution of Richardson, Soliman, Sloan, and Tuna (2005), and follow-ups like Larson, Sloan, and Zha-Giedt (2018), Casey, Gao, Kirschenheiter, Li, and Pandit (2017), and Ohlson (2014). The Richardson et al. (2005) definition is:

*Accruals are the changes in all non-cash assets and liabilities*

Although Richardson et al. (2005) does not discuss it as such, this is obviously a balance sheet-oriented (BSO) concept of accruals, driven by the values of assets and liabilities. The BSO concept of accruals has some key advantages; most importantly it is simple and clear, and it allows for a comprehensive measurement of accruals. While there are some tricky aspects like the treatment of near-cash assets and liabilities, preferred stock, and stock-based compensation, for the most part it provides a powerful and easy-to-use way of conceptualizing accruals.<sup>1</sup> For example, following the BSO view it is immediately clear that the Accounts Receivable accrual

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<sup>1</sup> Near-cash assets and liabilities can be treated either as cash or as non-cash assets and liabilities, with corresponding consequences for the definition of cash flows and accruals. Following a common-equity perspective, preferred stock is treated as a liability. Stock compensation expense does not affect assets and liabilities but affects income, so one solution is to use measures of income and accruals before the effect of stock compensation.

for a given period is the change in Accounts Receivable for that period, and there is little doubt how to measure it from readily available financial statement data.<sup>2</sup>

## 2. *Problems with the BSO concept of accruals*

The BSO concept of accruals has substantial limitations, however, especially if applied without proper understanding. At the broad philosophical level, the problem is that viewing accruals as asset and liability changes naturally focuses the attention on the balance sheet and the valuation of assets and liabilities. More specifically, uncritical focus on the BSO notion of accruals can lead to the impression that the key to having good accruals is the proper valuation of assets and liabilities. This seems logical within the BSO framework: if accruals are the changes of asset/liability values, the implication is that having “good accruals” means deriving “good” changes in assets/liabilities. In turn, this means that having methods for deriving good levels of asset/liabilities values is critical. In short, having good accruals and good accounting seems to boil down to having proper valuation technology for measuring asset and liability values. The problem is that such lines of thinking largely miss how accrual accounting actually works to reflect firm performance.

If the focus in reflecting firm performance is on firm *operations* - consistent with how managers, investors, and financial analysts view the firm - the implication is that the focus in accounting should naturally be on the income statement and income (Graham, Harvey and Rajgopal 2005). From an accounting perspective, company operations for most firms can be

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<sup>2</sup> The BSO view is problematic when there are increases in assets and liabilities due to mergers and acquisitions. Clearly, Accounts Receivable going up because the firm has more credit sales is quite different from Accounts Receivable going up because an acquired firm has existing Accounts Receivable. Similar considerations apply to other firm activities that change assets and liabilities without direct change in firm operations, e.g., corporate spin-offs and split-offs. Thus, the BSO definition needs some qualification with respect to M&As and analogous activities.

described as the dynamic and continual advancing of expenses to execute a business model, and earn revenue and income. Thus, the income statement and income are naturally the clearest accounting reflections of the success in firm operations. And if the focus should be on the determination of income, it follows that the determination of accruals should be driven by income-oriented considerations. This broad intuition is mostly lost in the BSO concept of accruals. Focusing on the valuation of assets and liabilities as the key to good accounting leads one astray from the core concern of how to use accruals to better reflect the success of advancing expenses to earn revenues and profits.

A related deficiency is that the BSO concept of accruals is largely silent on exactly how and why accruals transforms cash flow income into accrual income. Cash flows are essentially the bedrock facts of firm performance, where ultimate firm success is determined by the long-term excess of cash produced over cash used. Pure cash flows measures of firm performance, however, have well-known problems, e.g., Dechow (1994) describes them as “timing and mismatching problems in the cash flows”. A simple example of such problems is that cash spent today on PPE produces cash benefits over many future periods; as a result, everything else equal, a pure cash measure of income would show abnormally low income today and abnormally high future income.

Such problems are especially acute at relatively short reporting horizons because at such horizons the mismatches between the effects of cash spent on cash received are more severe. At the same time, the demand for continual control and adjustment of operations creates a need for timely signals of firm performance. Thus, the aim of producing timely signals of financial performance prompts the use of accrual adjustments, which shifts the recognition of cash flows

into accrual income across time. For example, the PPE/depreciation accruals shift the recognition of the PPE cash outflow from the period of purchase to the periods of PPE use.

Turning to the nuts and bolts of the accrual process, this shifting of recognition is accomplished by using two types of accrual adjustments, accruals and deferrals. Some accrual adjustments defer the recognition of cash flows into income *away* from the periods in which the cash flows occur, so they can be defined as deferrals, e.g., the capitalization of purchased PPE defers the recognition of a cash outflow away from the period in which it occurs. Notice that in the absence of deferrals such cash flows would flow directly into income. Notice also that deferrals work by creating an accrual adjustment with the same amount but the opposite sign of the corresponding cash flow, cancelling its effect on income.

For example, capitalizing a PPE cash purchase of \$100 involves creating a positive accrual of \$100 (an asset increase) which perfectly offsets the negative effect on income of the cash outflow of \$100. Using the link between accrual and cash income at time  $t$  for a more formal representation:

$$\text{Income}_t = \text{Corresponding Cash Flows}_t + \text{Corresponding Accruals}_t$$

$$\text{Income}_t = \text{PPE purchase} + \text{PPE asset increase}$$

$$0 = -\$100 + \$100$$

Thus, the capitalization of PPE defers the negative effect on income from the negative cash flow of \$100 *away* from the period in which the cash flow occurs.

Other accrual adjustments accrue the recognition of the corresponding cash flow *into* some period different from the one in which the cash flows occur, so such adjustments can be defined as accruals (or “accruals proper” to distinguish them from the generic accrual label that often includes deferrals), e.g, recording a series of depreciation expenses recognizes into

subsequent income the initial PPE expenditure. Extending the PPE example above, assume that the capitalized PPE value of \$100 will be depreciated straight line over 10 years, with no salvage value, so depreciation expense is \$10/year. The accrual effect on income for period t+1 can then be represented as follows:

$$\text{Income}_{t+1} = \text{Corresponding Cash Flows}_{t+1} + \text{Corresponding Accruals}_{t+1}$$

$$\text{Income}_{t+1} = 0 + \text{Depreciation expense}$$

$$-\$10 = 0 + (-\$10)$$

Thus, recording depreciation expense accrues -\$10 into income for period t+1, which represents the recognition of a portion of the \$100 PPE purchase negative cash flow into income in a period (t+1) different from that when the corresponding cash flow occurred (t). What the PPE example also reveals is that deferrals and accruals proper work in precisely choreographed tandems, of course, which is also referred as “accruals working in pairs” and the use of “originating and reversing accruals”.

The major implication of this example is that in the income-oriented view the principal role of accrual adjustments is to record the “correct” deferrals and accruals proper that shift the recognition of the corresponding cash flows away from the period in which they occur, and into income in the “right” periods. Critically, notice that the associated changes in non-cash assets and liabilities are more of a by-product of the accrual process, basically keeping track of incurred or anticipated cash flow values while the recognition of these cash flows into income remains in-process. Note also that for any given transaction, the effects of the accrual process on the changes in non-cash assets and liabilities reverse and disappear over time. In other words, the effects of the accrual process on the changes in non-cash assets and liabilities are *temporary*, where their existence is bookended by the temporal endpoints of the corresponding accrual pair.

For example, the opening accrual for an Accounts Receivable creates an increase in a non-cash asset but this asset only exists until the corresponding receivable is collected.

In contrast, the effect of the accrual process on the pattern of recognition of cash flows into income is *permanent*. The shift of recognition of cash collections from customers from the time they occur to Revenue at the time of the sale is accomplished through the initiation and reversal of the Accounts Receivable asset. But once this accrual pair is completed, the effect on assets/liabilities is zeroed out, while the shift of recognition into income remains. These core properties and functions of accrual accounting are close to invisible in the BSO concept of accruals – or at least not placed front and center where they belong.

The deficiencies of the BSO view of accruals at the conceptual level naturally trickle down into difficulties in addressing practical everyday accounting problems. One example of such problems is the question about the nature of accruals for no-growth firms. Do such firms even have accruals? Can the quality of accruals for such firms change over time? Intuitively, the answers must be “yes.” Yet, if a firm is in a steady state, zero growth means zero change in its assets and liabilities, which implies it has no BSO accruals. This seems strange, especially since no-growth and low-growth firms are not an oddity but actually quite common in the economy.

A deeper consideration along the lines of the income-oriented view of accruals presented above reveals that the answer lies in realizing that the BSO definition of accruals is about *net* accruals, which are the net result from the effect of all deferrals and accruals proper over a certain reporting period. For example, the net Receivable accrual for a steady-state firm may be zero – but the firm likely kept originating and collecting a lot of receivables to arrive at this end-of-period net result. Even more to the point, the two sides of this net accrual seem quite different in nature and result. Collecting the receivables is a more objective and verifiable activity backed

by easy to verify real-time cash flows. In contrast, the origination of receivables is at least somewhat subjective in amount and timing, driven by projections of future cash flows and possibly contract terms. In the case of long-term receivables like mortgages, the recorded value of the receivables can be quite discretionary, and can change dramatically over time. Thus, a net BSO accrual of zero can obscure critical features of the underlying accrual process that led to this result.

Summarizing, the BSO notion of accruals is not “wrong” – but it can be limiting, and even misleading. The danger is that it can become internalized and applied at face value, emphasizing the valuation of assets and liabilities as the guide to good accruals and good accounting. The end result from going in this direction is to actually obscure the core nature and function of accruals. Thus, at a minimum, it seems important to clarify that the BSO concept of accruals is more of a measurement-of-net-accruals approach rather than an accurate distillation of what accruals are and do. A more ambitious undertaking would be to further develop and characterize an income-oriented concept of accruals.

### *3. An income-oriented concept of accruals: Further directions and implications*

The broad strokes of an income-oriented concept of accruals are already outlined in the preceding analysis, with further development and specifics in this section. Perhaps the single most important point here is that the income-oriented concept of accruals remains entirely consistent with the BSO concept of accruals, while re-interpreting and extending it in critical ways. The quick intuition for why this is true is that the income statement and the balance sheet articulate, i.e., changes in income articulate with the changes in the corresponding assets and liabilities. In other words, changes in income and changes in assets/liabilities are really two sides

of the same coin, and the decision on which side of this duality to lean on at least partly depends on the decision context. For some applications, the BSO view is appropriate and may be enough. For some others, a lack of understanding of this duality can lead to misunderstanding and even error, as shown further below.

### *3.1 A closer look into the relation between the income-oriented and BSO view of accruals*

To examine more closely the intuition that income-oriented and BSO accruals are two sides of the same coin, consider the double-entry bookkeeping that involves accruals. In a nutshell, the BSO concept of accruals emphasizes the assets/liabilities side of these entries, with little attention to their other side. The income-oriented concept of accruals views the other side of these entries as primary in meaning and function, and the balance sheet effects as temporary and secondary. Thus, it is clear that the BSO and the income-oriented concept of accruals are internally consistent. But they could differ quite substantially in their interpretation of the nature and function of accruals.

To see an illustration of such differences, consider the case of asset increases, for example. In the BSO view of accruals, all asset increases have the same basic nature, they are “positive accruals”. To the income-oriented view of accruals, however, some types of asset increases look very different from others. Notice that in recording accruals changes in non-cash assets and liabilities are recorded with corresponding changes to either the Cash account or some kind of Income (Equity) accounts. For example, if there is an increase in some asset, it either happens because there is a corresponding decrease in the Cash account (e.g., a cash purchase of that asset) or because there is a corresponding increase in income or gain (e.g., recording an increase in Accounts Receivable and Revenue). The point is that the nature and function of

accruals are quite different for changes in non-cash assets and liabilities when the balancing entry is for Cash vs. Income accounts. This critical point is largely invisible in the BSO concept of accruals.

Starting with the Cash side, what is the nature of the accrual adjustments that constitute changes in non-cash assets and liabilities with a balancing entry against Cash? These are items like cash outflows for purchases of assets, and cash inflows for asset disposals, and cash inflows and outflows from the initiations and extinguishment of various liabilities and debts. In the absence of accrual adjustments, such cash inflows and outflows would flow directly into income. When combined with concurrent changes in non-cash assets and liabilities, however, the recognition of such cash flows is *deferred* away from current period. For example, in the absence of accruals a PPE purchase will be considered an immediate cash expense. As shown in more detail above, with accruals the PPE expenditure is capitalized as an asset, and its recognition as depreciation expense is deferred to future periods. Therefore, changes in noncash assets and liabilities that have a corresponding entry to Cash are *deferrals* of the associated cash flow.

And what is the nature of accrual adjustments that constitute changes in non-cash assets and liabilities with a balancing entry against Income? These are items like the originations of receivables, recording depreciation and other non-sale diminutions and expirations of assets, decreases of deferred revenues, and increases of payables and liabilities for incurred expenses. In the absence of accruals, these items will have no effect on income since there is no effect on cash inflows or outflows. When accrual adjustments are introduced, however, such items are *accrued* into income. For example, the PPE expenditure is recognized as depreciation expense with a concordant diminution of the PPE asset. Therefore, changes in non-cash assets and liabilities with a corresponding entry to Income are *accruals*. Or – since the generic name accruals is used

for both deferrals and accruals - these actual accruals can be called true accruals or accruals proper.

As mentioned above, accruals proper and deferrals do not work in isolation but in asynchronous-time pairs that accomplish the shifting of recognition of cash flows into income in periods different from which the cash flows occur. For each cash flow whose recognition into income is shifted to a period different from when it occurs, there is a corresponding pair of an accrual proper and a deferral. The deferral defers the recognition of the cash flow *away* from the period in which it occurs. The accrual proper accrues the recognition of the cash flow *into* some period different from the one in which it occurs. Thus, deferrals and accruals proper work together, and to a great extent the meaning of one is lost without the other. It is precisely in the absence of reflecting such fundamental relations that the BSO concept of accruals comes short, at least in its plain-vanilla and literal versions.

Note also that the temporal ordering of the deferral/accrual proper pairs depends on whether the recognition of the cash flows into income happens before or after the cash flow occurs. If the cash flow occurs first and the recognition into income second, the temporal ordering of the accrual adjustments is deferral first, and accrual proper second. For example, the deferral of the PPE expenditure occurs before the accrual of the depreciation expense into income. If the cash flow occurs after the corresponding recognition in income, the accrual proper happens first, and the deferral second. For example, the accrual proper for Accounts Receivable occurs before the deferral of the cash inflow at the collection of the receivable.

*3.2 What are the practical implications of an income-oriented concept of accruals?*

Perhaps most importantly, the income-oriented concept of accruals emphasizes the critical distinction between deferrals and accruals proper, which is mostly invisible in the BSO view of accruals. As mentioned above, to the BSO view of accruals all asset increases look similar, they are positive accruals. The income-oriented view, however, draws a sharp distinction between asset increases that represent accruals proper vs. deferrals. The capitalization of PPE, Inventory, and various prepaid assets represents deferrals, which cancel the effect of their contemporaneous corresponding cash flows on income. Recall also that recording such items involves little discretion because the amount of the deferral is pinned down by the value of the corresponding contemporaneous cash flow being deferred, see also Dichev and Owens (2024) on this point. In addition, the timing of the deferral is pinned down by the timing of the cash flow.

In contrast, recording an increase in Accounts Receivable accrues revenue and income. The amount and timing of this accrual is much more discretionary precisely because there is no concurrent cash flow to pin it down. A receivable may be recorded earlier or later, at larger or smaller amounts depending on reasonable interpretations of the provisions of a contract. The implication of such discretion is that there are corresponding differences in accrual estimation errors and quality of accruals for asset increases that represent deferrals vs. accruals, see Dichev and Owens (2024) for further development of this point. Of course, similar consideration apply for asset decreases, and liability increases and decreases.

The critical distinction between deferrals and accruals proper is helpful for both conceptual and practical purposes. At the conceptual level, it brings clarity to some long-standing questions and properties of accruals. As mentioned above, it easily answers the otherwise vexing questions of whether no-growth firms have accruals, and whether the quality of these accruals can change over time. The distinction between deferrals and accruals proper also

provides clear answers to other classic questions. For example, it has long been known that accruals are strongly negatively correlated with contemporaneous cash flows, e.g., Dechow (1994) and Dechow and Dichev (2002). This correlation has eroded over time, however, and has become close to zero in recent years. The reasons for the decline in this key property of accruals has been addressed in several studies, e.g., Bushman, Lerman, and Zhang (2016) point to the increase in special items as the dominant explanation but Green, Louis, and Sani (2022) attribute it to the secular increase in intangible investments and their omission in book values.

While a full reconciliation of these results is beyond the scope of this study, keeping in mind the fundamental split between deferrals and accruals proper provides a solid conceptual lens to organize and explain them. For example, it is immediately clear that deferrals and contemporaneous cash flows have a strong negative correlation by design – recall from the discussions above that the shifting of recognition of cash flows away from some period is accomplished by recording an accrual with the same amount and *the opposite sign* in the same period. In other words, for properly defined cash flows and deferrals, the correlation has to be -1. For example, recording the collection of Accounts Receivable of \$100 implies recording a positive cash flow of \$100, and a negative accrual of -\$100, so for properly defined cash flows and Accounts Receivable deferrals, the contemporaneous correlation has to be -1. Notice also that this core relation between deferrals and contemporaneous cash flows cannot “go away” over time because it is a core and unavoidable manifestation of how the accrual process works.

In contrast, the relation between contemporaneous cash flows and associated accruals proper is much more tenuous, and in fact there are good reasons to believe that it fluctuates, and that often it is positive. Some of such reasons have been already identified, e.g., Ball and Shivakumar (2006) point out that in poor economic times cash flows turn negative, and are also

often accompanied by large negative accruals due to asset write-downs and various charges like provisions for workforce reductions, implying a positive correlation between accruals and cash flows. But the positive relation between cash flows and accruals proper can also extend to good economic times. For example, a surge in consumer demand often translates into a concurrent surge of both cash and credit sales, which implies a positive correlation between cash collections from customers and Accounts Receivable positive accruals. The takeaway is that looking at the relation between cash flows and aggregated accruals (combining deferrals and accruals proper) can produce weak or puzzling results while such relations are much clearer and stronger at the deferral vs. accrual proper level.

The critical distinction between deferrals and accruals proper also makes much clearer the distinction between net and gross accruals, where the BSO view of accruals is mostly about net accruals while the income-oriented view of accruals is mostly about gross accruals. A simple example helps to clarify these points. Suppose a firm has beginning Accounts Receivable of \$100, new credit sales of \$300, cash collections of \$290, and ending Accounts Receivable (A/R) of \$110. The BSO view of accruals suggests that the A/R accrual for this period is the change in the account, so  $\Delta A/R = \$10$ . The income-oriented view of accruals is more concerned with the gross accruals for the period, which include new A/R accruals proper of \$300 (i.e., the origination of new receivables) and new A/R deferrals of \$290 (i.e., the collection of \$290 worth of A/R). Of course, the link between these two views of accruals is that the sum of the gross accruals is equal to the net accrual, i.e., as mentioned above, changes in the balance sheet accounts articulate with income accounts. For this example:

$$\text{Sum of gross A/R accruals} = \text{Net A/R accrual}$$

$$\text{A/R accruals proper} + \text{A/R deferrals} = \$300 + (-\$290) = \$10 = \Delta A/R$$

On the plus side, this A/R example provides confirmation that the BSO and the income-oriented view of accruals are internally consistent. The danger, however, is possible misunderstanding and confusion about “using the right accruals for the right purposes”. For example, poor understanding of the difference between net and gross accruals could result in regression specifications that are in effect mixing apples and oranges, and therefore producing results that are at odds with what was intended. Consider commonly used regressions of accruals on contemporaneous cash flows:

$$\text{Accruals}_t = \beta_0 + \beta_1 * \text{Cash Flows}_t + \varepsilon_t$$

where the typical goal is along the lines of isolating discretionary accruals or accrual estimation errors in the regression residuals, e.g., as in Ball and Shivakumar (2006). The point is that the implementation of this regression often has BSO/net accruals on the left-hand side while it has income-oriented/gross cash flows on the right-hand side. Using the A/R example above as an illustration, such implementation would include the net A/R accrual of \$10 on the left-hand side, and the cash flow of \$290 on the right-hand side. As one can immediately see, this is problematic because the collection of cash flows is clearly related to the A/R deferrals, i.e., to the reductions in A/R due to collections but not to the A/R accruals proper. Using the net A/R accrual on the left-hand side makes A/R accruals proper (i.e., the origination of new A/Rs for the period) intruding as “noise” in the clear relation between A/R deferrals and collections. In this example, putting the positive net A/R accrual on the left-hand side and positive cash flows on the right-hand side will result in a positive  $\beta_1$  coefficient, which will be “puzzling”.

In contrast, putting the gross A/R deferral of (-\$290) on the left hand side, and the cash collections of \$290 on the right hand side produces a  $\beta_1 = -1$ , which is exactly what it should be

in the absence of measurement errors and accrual estimation errors. Thus, failing to use the right accruals for the right purposes can be quite consequential.<sup>3</sup>

## 5. Conclusion

The dominant current notion of accruals is that they are the changes in non-cash assets and liabilities. This notion of accruals has some attractive features but can be misleading with regards to the core function of accruals in producing accounting income as the single most important measure of firm performance. The core function of accruals is to shift the recognition of some cash flows into income away from the periods in which these cash flows occur and into some other periods, creating an accrual measure of income which is a better measure of firm performance than cash income. Looking more closely into this function reveals the critical distinction between accruals and deferrals, where deferrals defer the recognition of a cash flow *away* from the period in which it occurs, and accruals (or more precisely, accruals proper) accrue the recognition of cash flows *into* periods different from those in which they occur. For example, the opening capitalization of a PPE cash purchase defers the recognition of the purchase cash flow away from the period in which it occurs, and the accrual of depreciation expenses gradually recognizes this cash flow into income in the subsequent periods.

Acknowledging this critical split brings needed conceptual clarities about the function and characteristics of accruals, which differ sharply between deferrals and accruals proper. The most important point is that deferrals defer the recognition of a cash flows away from the period

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<sup>3</sup> For clarity, this example uses the accruals and cash flows for a single account. Using aggregated measures of accruals and cash flows is probably less subject to the "mixing apples and oranges" problem identified in this example, e.g., putting working capital accruals on the left hand side and CFO on the right hand side will be less problematic in the sense that since the accruals proper act as the "noise" in this example, the variation of accruals proper will be less extreme in aggregate specifications where the accruals proper for assets will be at least partly offset by the accruals proper for liabilities. Nevertheless, the basic "mixing apples and oranges" problem remains at the aggregate level.

in which it occurs by recording a deferral which has the same value, the opposite sign, and the same period as the corresponding cash flows. Thus, the timing and magnitude of a deferral are pinned down by the timing and magnitude of the corresponding cash flow, and therefore with deferrals there is little room for discretion and estimation. In contrast, for accruals proper there is room for discretion and estimation with respect to timing and magnitude, and indeed such discretion and estimation can be from modest to enormous, especially for long-horizon accruals. In a nutshell, the essence of deferrals is along the lines of bookkeeping placeholders, and the real accrual action of discretion and estimation is confined to accruals proper.

The core distinction between deferrals and accruals proper brings not only broad conceptual clarity but significant insight into some long-standing properties and puzzles of accrual accounting. For example, it easily explains how no-growth firms can “have” accruals, and how these accruals can have different quality and characteristics over time. It also helps explain why accruals and contemporaneous cash flows have an unavoidable negative correlation, and whether and why such a correlation can weaken over time. Finally, it draws attention to the difference between gross and net accruals, where gross transaction-level deferrals and accruals proper accumulate over time to form the net accruals captured by the period-level changes in non-cash assets and liabilities. A major takeaway is that some applications call for net accruals, while some others demand gross accruals, and failure to distinguish between them can lead to confusions and improper specifications.

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