

# Discretionary Accruals, Cash Flow ,and Capital Investment

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## Abstract

We argue that the cash flow employed by earlier empirical studies of financing constraints differs from what is formally recognized in accounting. We decompose this informal cash flow into four components: cash flow from operations (formal cash flow), discretionary accruals, non-discretionary accruals, and depreciation.

We find that the significance of informal cash flow observed in previous empirical studies of financing constraints is derived from the robust explanatory power of discretionary accruals. In addition, the explanatory powers of formal cash flow and of non-discretionary accruals are fragile.

We further show that discretionary accruals are powerful determinants of capital investment because they contain manager's private information about future earnings.

Keywords: Discretionary accruals, Cash flow, Tobin's q, Capital investment  
Financing constraints, Income smoothing

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