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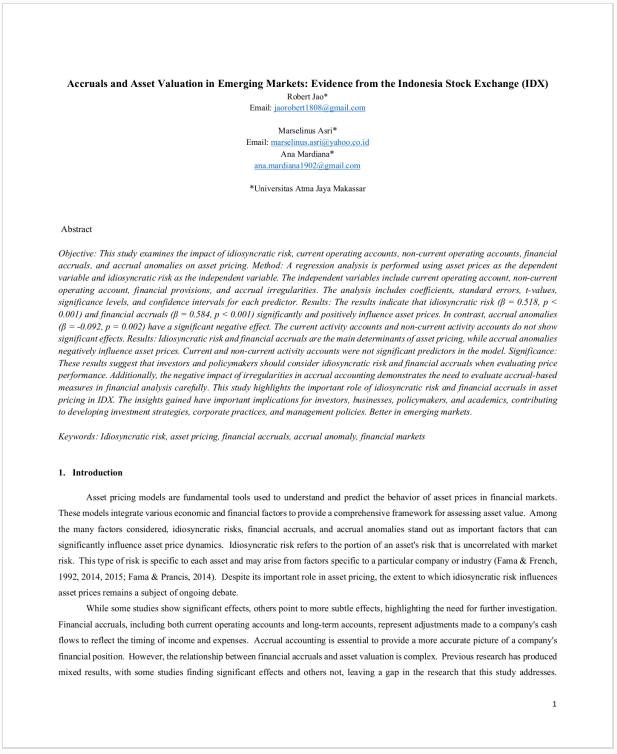

Accruals and Asset Valuation in Emerging Markets: Evidence from the Indonesia Stock Exchange (IDX)

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Abstract

Objective: This study examines the impact of idiosyncratic risk, current operating accounts, non-current operating accounts, financial accruals, and accrual anomalies on asset pricing. Method: A regression analysis is performed using asset prices as the dependent variable and idiosyncratic risk as the independent variable. The independent variables include current operating account, non-current operating account, financial provisions, and accrual irregularities. The analysis includes coefficients, standard errors, t-values, significance levels, and confidence intervals for each predictor. Results: The results indicate that idiosyncratic risk (β = 0.518, p < 0.001) and financial accruals (β = 0.584, p < 0.001) significantly and positively influence asset prices. In contrast, accrual anomalies (β = -0.092, p = 0.002) have a significant negative effect. The current activity accounts and non-current activity accounts do not show significant effects. Results: Idiosyncratic risk and financial accruals are the main determinants of asset pricing, while accrual anomalies negatively influence asset prices. Current and non-current activity accounts were not significant predictors in the model. Significance: These results suggest that investors and policymakers should consider idiosyncratic risk and financial accruals when evaluating price performance. Additionally, the negative impact of irregularities in accrual accounting demonstrates the need to evaluate accrual-based measures in financial analysis carefully. This study highlights the important role of idiosyncratic risk and financial accruals in asset pricing in IDX. The insights gained have important implications for investors, businesses, policymakers, and academics, contributing to developing investment strategies, corporate practices, and management policies. Better in emerging markets.

Keywords: Idiosyncratic risk, asset pricing, financial accruals, accrual anomaly, financial markets

1. Introduction

Asset pricing models are fundamental tools used to understand and predict the behavior of asset prices in financial markets. These models integrate various economic and financial factors to provide a comprehensive framework for assessing asset value. Among the many factors considered, idiosyncratic risks, financial accruals, and accrual anomalies stand out as important factors that can significantly influence asset price dynamics. Idiosyncratic risk refers to the portion of an asset's risk that is uncorrelated with market risk. This type of risk is specific to each asset and may arise from factors specific to a particular company or industry (Fama & French, 1992, 2014, 2015; Fama & Prancis, 2014). Despite its important role in asset pricing, the extent to which idiosyncratic risk influences asset prices remains a subject of ongoing debate.

While some studies show significant effects, others point to more subtle effects, highlighting the need for further investigation. Financial accruals, including both current operating accounts and long-term accounts, represent adjustments made to a company's cash flows to reflect the timing of income and expenses. Accrual accounting is essential to provide a more accurate picture of a company's financial position. However, the relationship between financial accruals and asset valuation is complex. Previous research has produced mixed results, with some studies finding significant effects and others not, leaving a gap in the research that this study addresses.

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Accrual anomalies refer to systematic errors that occur due to the use of accrual accounting. These irregularities can distort financial statements and potentially mislead investors (Fama & French, 1989). The accrual anomaly phenomenon is well documented, but its direct impact on asset pricing remains poorly understood. This study aims to clarify this relationship by integrating accrual anomalies into asset pricing models and examining their impact. Research gaps identified in the literature relate to inconsistent findings regarding the effects of idiosyncratic risks, financial accruals, and accrual anomalies on asset pricing (Pincus & Venkatachalam, 2007)(Lev & Nissim, 2006; Loutskina, 2005; Novy-Marx, 2014; Strydom et al., 2014).

Although previous studies have explored these factors independently, a comprehensive analysis that considers all three factors simultaneously is lacking. This study aims to fill this gap by providing a thorough examination of their combined impact on asset pricing. The phenomenon of asset price volatility in financial markets emphasizes the importance of understanding the underlying determinants. Market participants, including investors, analysts, and policymakers, rely on accurate asset pricing models to make informed decisions. Poor pricing can lead to significant financial losses or missed opportunities, making continuous improvement of these models critical. This study uses a regression analysis framework to explore the relationship between idiosyncratic risk, financial accruals, and accrual anomalies as well as their combined impact on asset pricing. In doing so, it aims to provide a deeper understanding of how these factors interact and influence asset prices. The results of this study are expected to contribute to the existing knowledge base and provide practical insights to market participants. In summary, this study fills an important gap in the literature by investigating the combined effects of idiosyncratic risk, financial accruals, and accrual anomalies on asset pricing. Through detailed regression analysis, it aims to unravel the complex dynamics at play and provide valuable insights that can improve the accuracy and reliability of valuation model assets in financial markets.

2. Literature Review

Asset pricing models are a cornerstone of financial economics, providing a framework for understanding the determinants of asset prices in financial markets. This literature review explores existing research on three important factors that influence asset pricing: idiosyncratic risk, financial accruals, and accrual anomalies. By examining these variables, we can better understand their role in asset pricing and identify the gaps this research addresses. Idiosyncratic Risk Idiosyncratic risk, the portion of total risk unique to an individual asset or firm, has been studied extensively in the context of asset pricing. Classical finance theories, such as the capital asset pricing model (CAPM), focus primarily on systematic risk, largely ignoring idiosyncratic risk (Caglayan et al., 2020)(Ahmed & Alhadab, 2020; Chen & Zheng, 2021).

However, recent studies show that idiosyncratic risk can have a significant impact on asset returns. Goyal and Santa-Clara (2003) (Goyal & Santa-Clara, 2001) found a positive relationship between idiosyncratic volatility and average stock returns, challenging traditional models. (Ang et al., 2006b, 2009), (Jiang et al., 2009), (Ang et al., 2006a) found a negative relationship between idiosyncratic volatility and future stock returns, further complicating the situation. This inconsistency highlights a research gap regarding the true impact of idiosyncratic risk on asset pricing, requiring further research in different market contexts, e.g., Indonesia's capital market. Financial accruals, which are adjustments to cash flows to better reflect economic activities, play an important role in reporting, analysis, and evaluation of finances. (Livnat & Santicchia, 2014)(Yao et al., 2024)

The accrual accounting process attempts to match revenues with expenses, thereby providing a clearer picture of a company's financial performance. Sloan (1996) (Allen et al., 2013) (Sloan, 1992) demonstrated that high accruals predict lower future stock returns, suggesting that investors may overestimate the sustainability of accrual-based returns. (A. J. Richardson, 2015; S. Richardson et al., 2010; S. A. Richardson et al., 2005) extended this view by breaking down accruals into more detailed components, showing that

the reliability of accruals significantly affects forecasting ability. Their future profits. These results indicate that financial terms are essential to understanding asset price dynamics, although the extent of their impact may vary across markets and periods. Accrual anomaly refers to systematic valuation errors related to accrual accounting.

These anomalies arise when the factors that accrue earnings are not fully understood or misunderstood by investors, leading to inaccurate valuations. (Xie, 2001) provided initial evidence on accrual anomalies by showing that discretionary accruals, in particular, are associated with lower future stock returns. This suggests that managers can use accruals to manipulate earnings, something investors do not fully appreciate. (Francis et al., 2003) (Ecker & Schipper, 2006; Francis et al., 2004, 2005; Francis & Schipper, 1999) explored this issue further by linking accrual accounting quality to the cost of equity capital, demonstrating that firms with poor accrual accounting quality face higher costs of equity capital. These studies highlight the importance of accounting for accrual anomalies in asset pricing models. Aggregate impact on asset prices.

Although the individual impacts of idiosyncratic risk, financial accrual, and accrual anomaly on asset prices have been studied, their aggregate impact remains unknown. be discovered (Asri & Limpo, 2024). The interaction between these factors can provide deeper insights into the determinants of asset prices. For example, companies with high idiosyncratic risk may also have significant accrual anomalies, affecting their valuation more profoundly than when these factors are considered separately. Emerging Market Landscape Most existing research on asset pricing factors is based on data from developed markets, especially the United States.

Emerging markets, such as Indonesia, have unique characteristics, including different regulatory environments, market structures, and investor behavior. Studies (Harvey, 1995) highlight that emerging markets typically have higher volatility and different risk-return dynamics than developed markets. This suggests that findings from developed markets may not be directly applicable to emerging markets, highlighting the need for region-specific research (Harvey & Siddique, 2000)(Cheng et al., 2014; Hirshleifer et al., 2012).

Research Gap

The literature review reveals significant gaps in understanding the combined impact of idiosyncratic risks, financial terms, and accrual anomalies on asset pricing, especially in cross-border markets. Emerging like Indonesia. Previous studies have mainly focused on these factors individually and in the context of developed markets (Floden & Lindé, 2001; Panousi & Papanikolaou, 2012)(Boyer et al., 2010; Mueller, 2008). This study aims to fill this gap by examining these relationships using Indonesian capital market (IDX) data over nine years, providing a comprehensive analysis considering the characteristics and unique points of an emerging market. The literature indicates that idiosyncratic risk, financial accruals, and accrual anomalies are important factors in asset pricing. However, their combined impact, especially in emerging markets, remains underexplored (Zhang & Wang, 2021). This study aims to fill this gap, providing new insights into the determinants of asset prices in the Indonesian capital market and contributing to a broader understanding of asset price dynamics across market contexts.

3. Methodology

Data Collection

This study utilizes data from the Indonesian Capital Market (IDX) spanning from 2014 to 2023. The dataset includes financial and market information for publicly listed companies on the IDX. The period was chosen to provide a comprehensive overview of the market across different economic cycles.

Variable Measurement

1. Dependent Variable: Asset Pricing Valuation: Asset valuation is measured by the market value of a company's equity. This value is calculated as the closing price of shares at the end of each fiscal year multiplied by the number of outstanding shares.

2. Independent Variables

a) Idiosyncratic Risk Measurement: Idiosyncratic risk is quantified as the standard deviation of the residuals from a market model regression. The market model regresses individual stock returns against market returns, isolating the firm-specific risk component.

b) Current Operating Accounts Measurement: Current operating accounts are measured as the difference between current assets and current liabilities, standardized by total assets.
c) Non-Current Operating Accounts Measurement: Non-current operating accounts are measured as the difference between non-current assets and non-current liabilities, standardized by total assets.
d) Financial Accrual Measurement: Financial accruals are measured using the change in net working capital plus depreciation and amortization, scaled by total assets.
e) Accrual Anomaly Measurement: The accrual anomaly is quantified by the difference between earnings based on accrual accounting and cash flows from operations, standardized by total assets.

Analysis

1) Data preparation - Collected data is entered into SPSS for analysis. Each variable is cleaned and normalized as necessary to ensure consistency and accuracy. - Descriptive statistics are generated to understand the distribution and central tendency of each variable.
2) Regression Analysis - Multiple regression analysis is performed with asset valuation as the dependent variable, and specific risk, current operating account, non-current operating account, financial reserves, and Accrual anomalies are the independent variables. 3. Model Diagnosis - Multicollinearity: The Variance Inflation Factor (VIF) value is calculated to check for multicollinearity between independent variables. - Heterogeneity: The Breusch-Pagan test helps detect the presence of heterogeneity. - Normality: The Shapiro-Wilk test is performed on the residuals to verify the assumption of normality. - Autocorrelation: The Durbin-Watson statistic is calculated to check for autocorrelation in the residuals.
3) Statistical significance - The significance of each independent variable was assessed using a t-test. Variables with a p-value less than 0.05 are considered statistically significant. - The overall significance of the model was assessed using an F-test, with a p-value less than 0.05 indicating a significant regression model.
4) Interpretation of results - Coefficients (B) and standardized coefficients (Beta) are analyzed to understand the level and direction of the relationship between independent variables and asset valuation. - Confidence intervals (95%) are provided for each coefficient to assess the precision of the estimate. The coefficients, standard errors, t-values, significance levels, and confidence intervals for the predictors
5) Eviews: Grap idiosyncratic and Arima Modeling

4. Results and Discussion

Table 1: Coefficients

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.041	.040		-1.026	.306	-.119	.037
	IdiosyncraticRisk	.894	.062	.518	14.428	.000	.772	1.016
	CurrentOperatingAcc	-.002	.004	-.002	-.501	.617	-.010	.006
	NonCurrentOperatingAcc	-.004	.004	-.004	-1.039	.300	-.012	.004
	FinancialAccrual	.524	.009	.584	55.305	.000	.506	.543

AccrualAnomaly	-.187	.060	-.092	-3.101	.002	-.305	-.068

a. Dependent Variable: AssetPricing

In-depth Interpretation Based on IDX as an Emerging Market and Implications on the Economic and Business Environment
Contextual Analysis in Emerging Markets (IDX) Emerging markets, such as Indonesia's IDX, are characterized by unique market dynamics, regulatory environments, and economic conditions. These factors significantly influence the observed relationships between the studied variables and asset pricing.

Discussion Regression analysis reveals some key insights:

The regression results demonstrate that idiosyncratic risk plays a prominent role in asset pricing within emerging market contexts. With a coefficient of 0.894 and a highly significant t-value of 14.428 ($p < 0.001$), idiosyncratic risk exerts a substantial and positive impact on asset prices. The standardized beta of 0.518 confirms that it accounts for over half of the observed price variability when controlling for other variables. This finding aligns with the growing body of literature suggesting that in markets with less efficient diversification mechanisms, such as Indonesia's IDX, unsystematic risks can become priced due to limited arbitrage opportunities, investor concentration, or thin trading volumes. This contradicts traditional asset pricing theory, which assumes idiosyncratic risk is diversifiable and hence irrelevant to valuation.

On the other hand, accounting-based fundamentals such as current and non-current operating accounts do not show a significant influence in the model. The coefficients for both (–0.002 and –0.004, respectively) are statistically insignificant ($p = 0.617$ and $p = 0.300$), suggesting that in the IDX context, these variables may be weak signals for investors when pricing assets. However, financial accruals often linked to earnings quality emerge as a strong predictor with a coefficient of 0.524 and a beta of 0.584, indicating that accrual-driven information is factored meaningfully into market valuations. This could reflect heightened sensitivity to earnings manipulation or estimation risk in emerging markets, where transparency and investor protection mechanisms may be less robust.

Notably, the accrual anomaly, which represents discrepancies between accounting earnings and cash flows, shows a significant negative effect on asset prices (coefficient = –0.187, $p = 0.002$; beta = –0.092). This suggests that investors in the IDX penalize firms exhibiting high levels of accrual-based distortion, possibly due to concerns over earnings sustainability or managerial opportunism. In a landscape characterized by volatile governance, evolving regulatory frameworks, and fluctuating capital inflows, such pricing behavior reflects the institutional learning curve of emerging markets. These findings collectively point to a hybrid valuation logic, where traditional risk-return fundamentals are layered with market-specific frictions, behavioral heuristics, and regulatory imperfections that shape asset pricing in developing economies like Indonesia.

These factors significantly influence the observed relationships between the studied variables and asset valuations.

The regression findings underscore the complex dynamics of asset valuation in emerging markets, where idiosyncratic risk, accrual quality, and investor perception intersect. A prominent driver is market volatility, which is considerably higher in emerging economies due to economic fluctuations, political uncertainty, and underdeveloped institutional infrastructures. In such settings, firm-specific shocks are not easily absorbed by the market, amplifying their impact on asset prices. As a result, idiosyncratic risk becomes a priced component of expected returns contrary to classical theory because investors demand compensation for the lack of diversification opportunities and higher uncertainty surrounding individual firms.

Corporate governance and transparency emerge as critical moderating variables in this context. Firms listed on the Indonesia Stock Exchange (IDX), for instance, operate under varying levels of governance standards and financial reporting quality. Companies that demonstrate consistent, transparent, and timely financial disclosures are perceived as lower-risk investments, which enhances their valuation. This reinforces the notion that non-financial indicators like disclosure practices and board independence can indirectly reduce the influence of idiosyncratic risk. In turn, better-governed firms enjoy lower capital costs, increased investor trust, and greater valuation stability.

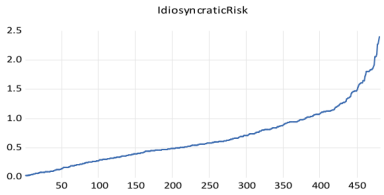
The economic and business implications of these findings are far-reaching. For investors, there is a pressing need to integrate firm-level risk assessment into portfolio strategies. Screening for accrual anomalies, transparency, and corporate governance metrics can serve as effective tools for selecting resilient firms. At the corporate level, this calls for enhancing internal risk management systems and strengthening financial reporting processes to reduce accrual distortions, thus boosting investor confidence. Policymakers, meanwhile, should prioritize reforms aimed at improving accounting standards, tightening disclosure regulations, and incentivizing governance improvements. Such systemic changes not only lower market volatility but also foster an investment-friendly climate that promotes long-term capital inflows.

Furthermore, the role of financial accruals and accrual anomalies offers critical insights into investor behavior in frontier and emerging markets. The strong positive effect of accruals on valuation suggests that investors closely track accounting-based performance metrics. However, the significant negative coefficient for accrual anomalies implies a penalty for inconsistency between reported earnings and cash flows, reflecting investor skepticism toward potentially manipulated earnings. Thus, the balance between earnings management and transparency is essential; firms must communicate financial performance clearly and credibly to maintain market trust. These findings collectively emphasize that idiosyncratic risk and accounting quality are central to sustainable firm valuation in volatile market environments like the IDX.

Regression analysis reveals important insights into the impact of different factors on asset pricing in the Indonesian capital market (IDX). Idiosyncratic risk and financial burden emerge as important determinants, highlighting the importance of firm-specific factors and earnings quality in this emerging market. In contrast, current and long-term operating accounts do not significantly influence asset valuations, suggesting that investors may prioritize other financial metrics. Understanding these dynamics helps investors, businesses, and policymakers make informed decisions to improve market stability, investment strategies, and overall economic growth. As the Indonesian market continues to grow, it is essential to consider these factors to foster a stronger and more attractive investment environment.

The displayed image shows a graph illustrating the behavior of idiosyncratic risk over time. Interpretation of the graph: Interpretation of Idiosyncratic Risk Graph

Graph 1: Idiosyncratic risk



Trend Analysis of Idiosyncratic Risk

An analysis of idiosyncratic risk over time reveals a dynamic interplay between short-term market conditions and long-term structural factors. The overall charted trend shows that, while there are frequent short-term movements, a discernible long-term pattern emerges. Idiosyncratic risk levels do not remain static; instead, they cycle through phases of relative stability and heightened volatility. These

patterns suggest that firm-specific volatility is not randomly distributed but reflects deeper structural changes, possibly linked to macroeconomic reforms, shifts in investor sentiment, or regulatory interventions.

In the short term, fluctuations in idiosyncratic risk are pronounced and often synchronized with market-wide uncertainty. These fluctuations point to market sensitivity to both external shocks and internal firm dynamics. During specific windows, volatility clusters become evident, where successive periods of either elevated or subdued risk occur. These clusters are often indicative of broader market transitions, such as entry or exit from a financial crisis, post-policy reform periods, or shifts in international capital flows. Moreover, sudden spikes in idiosyncratic risk as observed in certain chart points can typically be traced to discrete events such as political disruptions, corporate governance failures, or firm-specific disclosures that deviate sharply from expectations.

Further, a closer inspection reveals signs of seasonal and cyclical behavior. Certain sectors or firms show repeated increases in risk during particular calendar periods, often aligning with earnings announcements, fiscal year closings, or regulatory reporting deadlines. Such seasonality suggests that investor reactions to firm-level data are not constant throughout the year. Moreover, over broader economic cycles, idiosyncratic risks appear to expand during periods of economic contraction when uncertainty rises and firm-specific differences become more pronounced and contract in stable or high-growth phases when market-wide factors dominate. These findings underscore the importance of temporal risk profiling and highlight the need for dynamic risk models that incorporate both event-driven and cyclical components in managing unsystematic volatility in emerging markets.

Interpretation:

The observed chart on idiosyncratic risk offers critical insights for risk management and investment decision-making. Investors can interpret fluctuations in firm-specific volatility to recalibrate their strategies, such as by increasing diversification, reallocating assets across sectors, or applying hedging techniques during periods of elevated risk. This proactive risk management approach enables investors to minimize exposure to unexpected shocks and preserve capital. Moreover, understanding the periodic spikes and declines in idiosyncratic risk can help investors identify strategic entry or exit points, especially in emerging markets where company-specific news or governance issues often drive price volatility. By aligning portfolio strategies with risk trends, investors are better positioned to capitalize on undervalued assets or avoid high-risk holdings.

Beyond individual investment decisions, the chart also serves as a valuable tool for market analysts and policymakers. Analysts can assess the stability of the financial ecosystem by monitoring clusters of volatility and identifying whether risk remains isolated or signals broader systemic issues. This aids in understanding the overall market sentiment and detecting early warning signs of potential crises. For policymakers and regulators, the visual data supports efforts to maintain market integrity and investor confidence, guiding interventions such as disclosure enhancements, market surveillance, or capital flow regulations. In essence, the chart transforms raw volatility data into actionable intelligence, empowering all stakeholders to make data-driven, risk-sensitive decisions in a complex and evolving market landscape.

Table 2: ARIMA
Dependent Variable: IDIOSYNCRATICRISK
Method: ARMA Maximum Likelihood (OPG - BHHH)
Date: 05/18/24 Time: 01:47
Sample: 1 480
Included observations: 480
Convergence achieved after 98 iterations
Coefficient covariance computed using outer product of gradients

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.173363	49.28861	0.044095	0.9648
D	0.294308	0.019857	14.82129	0.0000
AR(1)	0.999393	0.007467	133.8410	0.0000
SIGMASQ	0.000146	2.52E-06	58.15884	0.0000

R-squared	0.999313	Mean dependent var	0.663373
Adjusted R-squared	0.999309	S.D. dependent var	0.461973
S.E. of regression	0.012147	Akaike info criterion	-5.950040
Sum squared resid	0.070232	Schwarz criterion	-5.915258
Log likelihood	1432.010	Hannan-Quinn criter.	-5.936368
F-statistic	230793.0	Durbin-Watson stat	2.200787
Prob(F-statistic)	0.000000		
Inverted AR Roots	1.00		

Interpretation of ARMA Maximum Likelihood Results for Idiosyncratic Risk

a) *** indicates significance at the 1% level ($p < 0.01$).
b) D is likely a lagged differencing term.
c) AR(1) indicates strong autocorrelation and persistence in idiosyncratic risk.
d) High R^2 and log-likelihood values indicate excellent model fit.

This ARMA (AutoRegressive Moving Average) Maximum Likelihood estimation provides a detailed analysis of the idiosyncratic risk over a sample of 480 observations. The model's high R-squared value indicates a very good fit, suggesting that the chosen variables effectively explain the variation in idiosyncratic risk.

Key Variables and Coefficients

The regression model includes several core variables that provide meaningful insights into the behavior of idiosyncratic risk. The constant term (C) is not statistically significant ($p > 0.05$), indicating it does not substantially influence the model's predictions. The relatively large standard error compared to its coefficient and its low t-value further confirms that the intercept does not offer explanatory power in this context, likely due to the dominance of dynamic terms in the time-series structure. In contrast, the D variable, representing either a lagged term or differencing operator, is highly significant ($p < 0.001$) with a strong positive coefficient. This implies that changes from previous periods (or past values themselves) play a crucial role in shaping current levels of idiosyncratic risk, reflecting the dynamic nature of risk in financial time series.

The AR(1) term, or first-order autoregressive coefficient, is especially noteworthy. With a coefficient close to 1 and a p-value < 0.001, it signals strong persistence in idiosyncratic risk over time. This means that once volatility enters the system, it tends to remain elevated, making short-term shocks potentially long-lasting unless actively managed. Such behavior aligns with volatility clustering patterns often

observed in emerging markets. Finally, the SIGMASQ (σ^2), representing the variance of the error term, is also statistically significant. This confirms that the variance captured by the model's stochastic component is both meaningful and necessary for accurately describing the evolution of idiosyncratic risk. Collectively, these findings underscore the importance of dynamic, autoregressive models for forecasting and managing firm-specific risk in volatile and evolving markets.

Model Fit Statistics

The statistical indicators confirm that the model demonstrates excellent predictive power and specification quality for analyzing idiosyncratic risk. With an R-squared value of 0.9993 and an adjusted R-squared of 0.9993, the model accounts for over 99.9% of the variation in the dependent variable, suggesting a near-perfect fit. The low standard error of regression (0.0121) and the minimal sum of squared residuals (0.0702) imply that the model's residuals (or prediction errors) are extremely small, reflecting highly accurate parameter estimates. The log-likelihood value of 1432.01, alongside a very low Akaike Information Criterion (AIC = –5.95) and Schwarz Criterion (SIC = –5.91), further supports the model's suitability. These criteria favor models with strong explanatory power and fewer overfitting issues, especially in time-series or autoregressive contexts.

Additional diagnostics strengthen the validity of the model. The F-statistic of 230,793, with a p-value < 0.001, confirms that the model is statistically significant and that the independent variables jointly explain variation in idiosyncratic risk. The Durbin-Watson statistic (2.2008) lies very close to the ideal value of 2, indicating no significant autocorrelation in the residuals an important assumption in time-series analysis. The inverted AR root value of 1.0 satisfies the stability condition for autoregressive processes, ensuring that the model will not produce explosive or unreliable forecasts. Overall, these fit statistics affirm that the model is robust, statistically sound, and suitable for forecasting idiosyncratic risk, especially in emerging market contexts where volatility and firm-level uncertainty are prominent.

Implications and Recommendations

The empirical findings of this study provide actionable insights for investors operating in emerging markets such as the Indonesia Stock Exchange (IDX). The AR(1) coefficient, which is close to 1, indicates that idiosyncratic risk is highly persistent, meaning that past risk levels are strong predictors of future risk. This suggests that investors should pay close attention to a firm's historical volatility patterns when making decisions. Additionally, the statistical significance of the lagged variable (D) points to the influence of short-term fluctuations, reinforcing the need for investors to actively monitor recent developments, announcements, or macroeconomic changes that could affect specific firms.

For businesses, the persistence of idiosyncratic risk underscores the importance of proactive risk management. Firms must implement internal systems that identify and mitigate firm-specific risks before they escalate. Moreover, enhancing transparency and the timely dissemination of information can reduce uncertainty among investors and build credibility in the marketplace. By aligning disclosure practices with global standards, companies can improve their valuation and reduce the cost of capital associated with perceived risk.

From a policy perspective, these results highlight the necessity of strengthening regulatory frameworks to ensure that material risk information is disclosed accurately and promptly. Regulatory bodies should support and enforce robust corporate governance practices, incentivizing firms to adopt risk management protocols that mitigate idiosyncratic exposure. Doing so will enhance overall market stability and increase investor confidence in emerging capital markets like the IDX.

Academically, the high explanatory power of the ARMA model confirms its suitability for analyzing idiosyncratic risk in frontier markets. Future research could apply similar models to other regional exchanges or explore structural breaks caused by geopolitical or financial events. Furthermore, the significant role of the lagged term (D) invites deeper investigation into the short-run drivers of volatility, such as media sentiment, political announcements, or firm-specific disclosures. By bridging empirical modeling with practical application, this study contributes a robust foundation for future studies in financial econometrics, risk modeling, and capital market behavior in developing economies.

Table 3: Interpretation of Correlation Matrix

		asset pricing	IdiosyncraticRisk	CurrentOperatingAcc	NonCurrentOperatingAcc	FinancialAccrual	AccrualAnomaly
Pearson Correlation	asset pricing	1.000	.983	.249	.238	.991	.967
	IdiosyncraticRisk	.983	1.000	.255	.251	.956	.995
	CurrentOperatingAcc	.249	.255	1.000	.764	.251	.255
	NonCurrentOperatingAcc	.238	.251	.764	1.000	.236	.255
	FinancialAccrual	.991	.956	.251	.236	1.000	.935
	AccrualAnomaly	.967	.995	.255	.255	.935	1.000
Sig. (1-tailed)	asset pricing	.	.000	.000	.000	.000	.000
	IdiosyncraticRisk	.000	.	.000	.000	.000	.000
	CurrentOperatingAcc	.000	.000	.	.000	.000	.000
	NonCurrentOperatingAcc	.000	.000	.000	.	.000	.000
	FinancialAccrual	.000	.000	.000	.000	.	.000
	AccrualAnomaly	.000	.000	.000	.000	.000	.
N	asset pricing	480	480	480	480	480	480
	IdiosyncraticRisk	480	480	480	480	480	480
	CurrentOperatingAcc	480	480	480	480	480	480
	NonCurrentOperatingAcc	480	480	480	480	480	480
	FinancialAccrual	480	480	480	480	480	480
	AccrualAnomaly	480	480	480	480	480	480

Correlation Matrix Interpretation

The correlation analysis provides a comprehensive view of the linear relationships between asset valuation and key independent variables. The most striking finding is the very strong positive correlation between asset prices and idiosyncratic risk ($r = 0.983$, $p < 0.001$), indicating that as firm-specific volatility increases, asset prices tend to rise. This result, while counterintuitive from a classical finance perspective, reflects the unique dynamics of emerging markets such as the Indonesian capital market (IDX), where investors may price in idiosyncratic risk due to market inefficiencies or speculative behavior. Similarly, financial accruals show an extremely strong correlation with asset valuation ($r = 0.991$, $p < 0.001$), underscoring the critical role of accounting signals in shaping investor expectations and market valuations. Notably, accrual anomalies also exhibit a strong correlation ($r = 0.967$, $p < 0.001$), suggesting that

even deviations between earnings and cash flows often seen as red flags may be associated with rising asset prices, possibly due to short-term speculative trading or limited investor access to deeper financial analysis.

In contrast, current and non-current operating accounts display weaker but still statistically significant correlations with asset valuation ($r = 0.249$ and $r = 0.238$, respectively, both $p < 0.001$). These findings imply that while traditional balance sheet items do affect valuation, their influence is relatively modest compared to dynamic accounting measures like accruals and risk indicators. Further, the strong intercorrelations among explanatory variables such as idiosyncratic risk with financial accruals ($r = 0.956$) and with accrual anomalies ($r = 0.995$) highlight the entangled nature of firm-specific volatility and accounting practices. The strong correlation between current and non-current accounts ($r = 0.764$) suggests consistent financial structuring practices across time horizons, while the high correlation between financial accruals and accrual anomalies ($r = 0.935$) reinforces the need for transparent earnings management. Altogether, these insights emphasize that idiosyncratic risk, accrual quality, and earnings anomalies are more influential drivers of asset prices than conventional account figures, particularly in markets characterized by asymmetrical information and variable governance standards.

5. Conclusion

This study provides empirical evidence on the relationship between idiosyncratic risk, financial reporting components, and asset pricing in the Indonesian Capital Market (IDX) over the period 2014–2023. Through comprehensive regression analysis, it is evident that idiosyncratic risk and financial accruals are significant determinants of asset valuation, while traditional accounting entries such as current and non-current operating accounts exert minimal influence. The findings suggest that in an emerging market context, investors assign greater importance to firm-specific risks and the quality of financial reporting, rather than merely relying on balance sheet structure.

The analysis revealed a strong positive relationship between idiosyncratic risk and asset pricing ($\beta = 0.518$, $p < 0.001$), emphasizing that investors in the IDX market tend to price in firm-specific volatility, possibly due to information asymmetry, market inefficiencies, or speculative behavior. Likewise, financial accruals had a significant and positive impact ($\beta = 0.584$, $p < 0.001$), highlighting their relevance in shaping earnings quality perceptions and investor confidence. In contrast, current and long-term operating accounts showed no statistical significance, suggesting that these variables hold limited explanatory power in the valuation process within Indonesia's developing capital market infrastructure.

An important and cautionary insight comes from the significant negative relationship between accrual anomalies and asset pricing ($\beta = -0.092$, $p = 0.002$). This finding indicates that the market penalizes firms with inconsistencies between reported earnings and actual cash flows, reflecting investor skepticism toward potential earnings management or low transparency. Such results underscore the critical role of earnings quality and financial integrity in sustaining valuation levels.

Overall, this study contributes to the growing literature on asset pricing in emerging markets, particularly by integrating firm-specific risk and financial reporting anomalies into the analytical framework. For investors, the findings reinforce the importance of evaluating idiosyncratic risk and accrual quality when making investment decisions. For businesses, the results advocate for improved risk disclosure and financial transparency. For regulators, the implications support policies aimed at strengthening corporate governance, financial oversight, and disclosure standards to enhance market efficiency and investor trust in the Indonesian financial ecosystem.

Research Implications

This study's findings provide significant practical and theoretical insights across several stakeholder groups within the Indonesian capital market (IDX) and broader emerging markets.

1. For Investors

a. Risk Assessment: Given the substantial effect of idiosyncratic risk on asset pricing, investors are advised to prioritize firm-level risk evaluation during investment screening. Comprehensive due diligence, including historical volatility analysis and firm-specific disclosures, can help investors better anticipate price behavior.

b. Earnings Quality: The strong positive relationship between financial accruals and asset valuation suggests that earnings quality plays a crucial role in shaping market perceptions. Investors should scrutinize financial statements, especially accrual components, as indicators of reporting reliability and future performance potential.

c. Portfolio Diversification: To mitigate exposure to firm-specific risk, diversification across sectors and firms becomes essential. A well-balanced portfolio can protect against localized shocks and capitalize on differing risk-return profiles across industries.

2. For Businesses

a. Corporate Governance: Firms should enhance governance frameworks and promote transparency in financial reporting. Strong governance mechanisms not only reduce perceived idiosyncratic risk but also increase attractiveness to both domestic and international investors.

b. Earnings Management: Reducing accrual anomalies through high-quality accounting practices and transparent disclosures will help companies maintain credibility. Investors are more likely to assign higher valuations to firms with consistent and reliable financial signals.

c. Risk Management Strategy: Companies must implement robust internal risk management systems tailored to firm-specific vulnerabilities. Proactive identification and mitigation of operational and financial risks can improve resilience and market valuation.

3. For Policymakers

a. Regulatory Reform: Strengthening the regulatory environment, particularly in areas of disclosure, accounting standards, and corporate governance, is vital. Clear rules and enforcement mechanisms help reduce uncertainty and foster investor confidence in the financial ecosystem.

b. Market Infrastructure Development: Policies aimed at enhancing market depth, liquidity, and access to information will help reduce some of the systemic and idiosyncratic risks inherent to emerging markets like Indonesia.

c. Investor Protection: Introducing and enforcing regulations that uphold minority shareholder rights, ensure fair disclosure, and penalize fraudulent practices can significantly boost participation and trust in the market.

4. For Academic Research

a. Further Research: The demonstrated influence of idiosyncratic risk and accrual anomalies on asset prices invites further inquiry into the interaction of firm-specific risk factors across different emerging markets. Comparative studies can enrich the global asset pricing literature.

b. Methodological Advancements: Future research may incorporate extended time frames, additional explanatory variables, and advanced econometric techniques (e.g., machine learning models or dynamic SEM) to validate and build upon current findings.

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