ABSTRACT: We decompose book-to-market (BP) ratio into book-to-intrinsic value (BV) ratio and intrinsic value-to-market (VP) ratio to shed further light on the debate of whether accruals and accrual anomaly are associated more with the risk/growth component (BV) or with the mispricing component (VP). Using both portfolio and regression approaches, we provide evidence that the accruals are mainly driven by the risk/growth component. We also find that BV and VP can at least partially explain the accrual anomaly and the explaining power is mainly attributable to the risk/growth component. Our results also confirm the advantage of BP decomposition. The explaining power of the accrual-return relation is significantly enhanced using both the BV and the VP components compared to using BP alone. Overall, our evidence supports the risk/growth argument in prior literature (e.g. Zhang 2007 and Wu et al. 2010). In addition, our results complement Resutek (2010) who finds that accrual anomaly is mainly driven by intangible returns rather than tangible returns. Additional validation analysis shows that our BV measure indeed reflects firm risk and growth characteristics.

JEL Classification: G12, G14, M41.

Keywords: book-to-market decomposition; accrual anomaly; risk/growth; mispricing.

Data Availability: Data are available from public sources indentified in this study.

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