

# Theoretical Analysis of the Quality of Corporate Financial Information under the New Revenue Standard

-- From the Perspective of Accounting Conservatism

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## ABSTRACT

The deepening of global economic integration has promoted the gradual convergence of accounting standard systems across countries, particularly regarding reforms in the critical field of revenue recognition. International Financial Reporting Standards (IFRS) have undergone continuous revisions and been widely adopted worldwide. China's accounting standards have gradually converged with international standards over the past few years. Notably, in 2017, the Ministry of Finance issued Accounting Standard for Business Enterprises No. 14 - Revenue, which has been implemented since 2018. The introduction of this new revenue standard marks a major transformation of China's accounting system. This study aims to explore how the new revenue standard affects the quality of corporate financial information. Specifically, from the perspective of accounting conservatism, it analyzes how enterprises balance flexibility and conservatism while complying with the new standard to ensure the reliability and relevance of financial information. This research holds significant theoretical and practical value for improving the theory of revenue recognition, enhancing the transparency of corporate financial reports, and providing policy recommendations for regulatory authorities.

## KEYWORDS

New Revenue Standard; Accounting Conservatism; Quality of Financial Information

## 1. THEORETICAL FOUNDATIONS AND CONCEPT DEFINITION

### 1.1. Evolution of Revenue Recognition Theory

The theory of revenue recognition has gone through three main developmental stages: from the initial realization basis, to the subsequent accrual basis, and to the current control transfer basis. Each stage responds to the increasing complexity of economic activities and the demand for greater transparency in corporate financial statements.

**Realization Basis:** The earliest revenue recognition standard was based on the point at which a transaction is completed, and it applied to simple transactions such as commodity sales. Under this basis, revenue is typically recognized when goods are delivered or services are completed. However, this method is overly simplistic and struggles to address the diverse transaction models in modern economic activities [1].

**Accrual Basis:** This theory emphasizes the matching of revenues and expenses, asserting that revenue should be recognized when the relevant economic activities occur, rather than when cash is actually received. The accrual basis makes accounting information more aligned with the actual operating

results, but it also introduces complexity in determining the recognition timing and increases reliance on management judgment.

**Control Transfer Basis:** The new revenue standard is built on the "control transfer" theory, under which revenue is recognized when the customer obtains control of the relevant asset. Compared with the traditional "transfer of risks and rewards" principle, this theory places greater emphasis on the economic substance of transactions. Especially for complex transactions such as long-term contracts and installment payments, the control transfer model can provide a more accurate timing for revenue recognition. Nevertheless, it also expands the scope for management judgment, which may lead to earnings management and information distortion [2].

## **1.2. Accounting Conservatism Theory**

Accounting Conservatism refers to an accounting treatment principle that tends to understate assets and revenues, and recognize liabilities and expenses prematurely when facing uncertainty and ambiguity. In accounting practice, conservatism plays a role in protecting investors and other stakeholders, preventing enterprises from reporting financial performance overly optimistically [3].

Accounting Conservatism helps curb earnings management behaviors of management and enhance the credibility of financial reports. The accounting conservatism model proposed by Basu (1997) demonstrates how it provides valuable information in an uncertain environment by asymmetrically recognizing the response speed of bad news and good news.

**Static Conservatism:** Reflected by understating assets or overstating liabilities, it ensures that financial statements do not mislead decision-makers due to overestimation of assets. This approach can effectively prevent the occurrence of earnings management.

**Dynamic Conservatism:** Reflected by adjusting the timing of recognition, it ensures that profits and losses can timely reflect the actual operating status of an enterprise. In some cases, conservatism requires accountants to exercise prudence when recognizing revenues and delay the recognition of revenues to avoid information distortion caused by premature recognition.

The implementation of the New Revenue Standard increases the flexibility of revenue recognition. When judging the timing of "control transfer", management needs to make subjective judgments based on factors such as contract content and performance obligations. This flexibility may conflict with accounting conservatism, leading to a decline in the reliability of financial reports.

## **1.3. Connotation of Financial Information Quality**

Financial information quality is a criterion for measuring how helpful accounting information is to decision-makers. Its quality is usually reflected in the following four dimensions:

**Relevance:** Information should have the ability to influence decision-makers' decisions and provide valuable support for predicting future cash flows.

**Reliability:** Information must truly reflect the economic substance of an enterprise and not be interfered by human factors. The reliability of financial information is the basis for users to trust financial reports.

**Comparability:** Information across different time periods or between different enterprises can be reasonably compared to evaluate an enterprise's long-term performance and competitiveness.

**Understandability:** Information should be presented in a clear and concise manner to ensure that users can correctly understand it and make reasonable decisions.

The implementation of the New Revenue Standard has improved the relevance of revenue recognition, but the increased room for management judgment may weaken the reliability of information. In

addition, the flexibility of revenue recognition may lead to a decline in the transparency of financial information, affecting comparability and understandability.

#### **1.4. Theoretical Analysis Framework**

This paper constructs the following theoretical analysis framework to systematically analyze the impact of the New Revenue Standard on financial information quality:

New Revenue Standard (Control Transfer) → Increased Judgment in Revenue Recognition → Changes in Accounting Conservatism → Changes in Financial Information Quality

This framework reveals the interaction between the flexibility of revenue recognition and accounting conservatism, which in turn affects the multi-dimensional changes of financial information quality. Specifically, the logic of this framework includes four key links:

##### **1.4.1. New Revenue Standard (Control Transfer)**

The core principle of the New Revenue Standard is "control transfer", which means an enterprise recognizes revenue when the customer obtains control of the asset, rather than solely relying on the traditional principle of "transfer of risks and rewards". The fundamental purpose of this change is to more accurately reflect the economic substance of transactions between enterprises and customers, especially in complex transactions and diversified contracts—such as long-term service contracts, lease contracts, and transactions involving variable consideration [4]. The control transfer principle requires enterprises to carefully determine whether the conditions for revenue recognition are met in each transaction, particularly regarding the identification of performance obligations, the allocation of transaction prices, and the estimation of variable consideration.

However, the implementation of control transfer enhances the flexibility of revenue recognition, as it depends on the enterprise's judgments, especially in the following aspects:

Definition of performance obligations: Enterprises need to determine the timing of fulfillment for each performance obligation in the contract, which may involve significant subjective factors.

Judgment on whether control transfer conditions are met: This requires enterprises to conduct an in-depth analysis of whether the customer has obtained control of the asset, and such a judgment is not always straightforward.

In practice, this change provides enterprises with greater flexibility but also makes the timing of revenue recognition more subjective and variable. As the scope of such judgment for enterprises gradually expands, management may face challenges in correctly defining the timing of revenue recognition, while also being subjected to pressure for earnings management.

##### **1.4.2. Increased Judgment in Revenue Recognition**

The increased judgment in revenue recognition is a direct consequence of the New Revenue Standard's implementation. Enterprise management faces a broader scope of judgment when recognizing revenue, particularly in the following areas:

Identification of performance obligations: Management needs to clarify which parts of the contract constitute performance obligations, when these obligations can be considered fulfilled, and whether they meet the criteria for control transfer.

Judgment on the variability of transaction prices: Under multi-term transaction conditions (e.g., refunds, discounts, or rebates), how to estimate and reasonably allocate transaction prices has become a key issue.

Estimation of revenue recognition timing: In the multi-step performance process, the timing of revenue recognition is often influenced by the enterprise's judgment on contract progress and the completion status of performance obligations.

This flexibility not only provides enterprises with opportunities to optimize financial statements based on their own judgments but also makes the revenue recognition process more dependent on the professional judgment of management. Due to the increased flexibility in revenue recognition, management may tend to recognize revenue in advance—a tendency that could increase the volatility of future earnings and elevate the risks associated with financial reporting.

#### 1.4.3. Changes in Accounting Conservatism

Accounting Conservatism is a crucial concept in accounting theory, referring to the principle of exercising prudence in revenue recognition and recognizing liabilities in a timely manner within accounting treatment principles. Conservatism acts as a check-and-balance mechanism for enterprise financial reporting, effectively curbing earnings management and the subjective judgments of management. However, as the need for judgment in revenue recognition increases, Accounting Conservatism is also affected.

Conflict between increased flexibility and conservatism: The New Revenue Standard introduces greater flexibility, allowing management to determine the timing of revenue recognition based on their own judgments. This flexibility may lead to earlier revenue recognition, weakening Accounting Conservatism—since overly optimistic revenue recognition may understate liabilities and overstate revenues, thereby distorting financial statements.

Role of the conservatism principle: Within this framework, conservatism still plays a vital role. It requires accountants to exercise prudence and avoid overly aggressive revenue recognition. To balance management’s subjective judgments and information reliability, conservatism has become a key constraint mechanism under the New Revenue Standard. Conservatism can enhance the reliability of financial reporting by reducing the risk of over-recognizing revenue, but excessive conservatism may also diminish the relevance of information.

Dynamic Conservatism: Under the New Revenue Standard, enterprises may flexibly adjust their financial reporting strategies in different revenue recognition scenarios and use Dynamic Conservatism for control. This means that in practice, enterprises dynamically adjust the timing of revenue recognition and the level of conservatism based on the complexity of business operations and the characteristics of contracts, to ensure the reliability and relevance of information.

#### 1.4.4. Changes in Financial Information Quality

Ultimately, the interaction between the New Revenue Standard and Accounting Conservatism affects the quality of financial information. The quality of financial information is primarily reflected in four dimensions: relevance, reliability, comparability, and understandability. The implementation of the New Revenue Standard exerts a profound impact on these dimensions:

Relevance: By enhancing the flexibility of revenue recognition, the New Revenue Standard improves the relevance of financial information. More granular revenue recognition can better reflect an enterprise’s operating conditions and its ability to predict future cash flows. However, this flexibility may lead to a trade-off between relevance and reliability—especially when the timing of revenue recognition is excessively advanced, relevance may be compromised.

Reliability: Flexible revenue recognition rules may result in over-reliance on management’s judgments, which affects the reliability of information. Although the New Revenue Standard emphasizes the economic substance of transactions, excessive flexibility may also cause distortions in financial reporting and reduce information reliability. For example, recognizing revenue too early or incorrectly estimating the completion of performance obligations will lead to a mismatch between financial reports and the enterprise’s actual operating conditions.

Comparability: The introduction of the New Revenue Standard improves the adaptability of revenue recognition under diversified contracts. However, due to the increased flexibility in the timing of revenue recognition, there may be differences in revenue recognition criteria across different

enterprises, thereby undermining information comparability. If revenue recognition criteria and judgments are inconsistent among enterprises, it will make it difficult to compare their financial reports.

Understandability: The increased flexibility and complexity of revenue recognition raise the difficulty of understanding financial information. In particular, when enterprises disclose details of revenue recognition, failure to clearly present the basis for management's judgments and the division of performance obligations may lead to a decline in information understandability. Therefore, when complying with the New Revenue Standard, enterprises need to enhance disclosure transparency to ensure the understandability of financial reports.

## **2. THEORETICAL ANALYSIS OF THE IMPACT OF THE NEW REVENUE STANDARD ON FINANCIAL INFORMATION QUALITY**

### **2.1. Core Changes of the New Revenue Standard**

The New Revenue Standard specifies the revenue recognition process in detail through a five-step approach. These five steps include: identifying the contract, identifying performance obligations, determining the transaction price, allocating the transaction price to each performance obligation, and recognizing revenue when the performance obligation is satisfied. Each step requires enterprises to make judgments based on the specific circumstances of the contract, especially regarding whether a performance obligation has been satisfied and how to allocate the transaction price. Such subjective judgments make the timing of revenue recognition more flexible [5].

This change means that when recognizing revenue, enterprises must not only consider the economic substance of the transaction but also rely on management's judgments. This creates room for earnings management and may affect the transparency and reliability of financial reports.

### **2.2. Impact of Increased Judgment in Revenue Recognition on Conservatism**

The New Revenue Standard increases the need for judgment in revenue recognition, particularly in determining whether a performance obligation has been satisfied and whether variable consideration exists. The subjective judgments of enterprise management may lead to early recognition of revenue, thereby affecting the reliability of the enterprise's financial statements. This flexibility may sometimes deviate from actual economic activities, resulting in increased risks of earnings management.

### **2.3. Trade-off of Information Quality from the Perspective of Conservatism**

From the perspective of conservatism, there is a dynamic trade-off between the flexibility of revenue recognition and conservatism. Excessively conservative practices may reduce the relevance of information, as financial statements fail to timely reflect the enterprise's actual economic activities. On the other hand, overly flexible revenue recognition may weaken the reliability of information, making financial statements no longer truly reflect the enterprise's operating results. Therefore, how to balance conservatism and flexibility is the key to improving the quality of financial information.

### **2.4. Management Discretion and the Risk of Information Distortion**

With the expansion of management's discretionary space under the New Revenue Standard, the risk of information distortion has also increased. Management may use this discretionary space to engage in earnings management, such as recognizing revenue in advance or delaying the recognition of expenses, to optimize financial performance. Such behaviors may lead to distortions in financial reports and reduce the reliability of information.

### **3. IMPROVEMENT PATHS AND POLICY RECOMMENDATIONS**

#### **3.1. Improve the Disclosure System for Revenue Recognition**

Enterprises should enhance the disclosure of the revenue recognition process, clarifying the basis for judgments in revenue recognition, the criteria for classifying performance obligations, and the estimation methods for variable consideration. By increasing information transparency, enterprises can help investors and regulatory authorities better understand their revenue recognition process, thereby improving the reliability and credibility of financial reports.

#### **3.2. Strengthen Professional Judgment and Accountants' Responsibilities**

The key to revenue recognition lies in the professional judgment of accountants. Efforts should be made to improve the quality of judgments in the revenue recognition process by enhancing professional training, increasing the independence of accountants, and refining professional ethics standards. In addition, a responsibility tracing mechanism should be established to hold accountable behaviors that significantly deviate from reasonable judgments.

#### **3.3. Enhance Internal Controls and External Supervision**

Enterprises should strengthen internal controls, particularly focusing on risk assessment and approval procedures in the revenue recognition process. External audit institutions should also intensify audit efforts on revenue recognition to ensure the rationality and transparency of revenue recognition.

#### **3.4. Draw on International Experience to Optimize System Design**

By learning from the experience of International Financial Reporting Standards (IFRS 15), China can ensure that the revenue recognition system is sufficiently flexible and transparent when formulating and improving it, preventing information distortion caused by excessive flexibility in revenue recognition.

### **4. CONCLUSIONS AND PROSPECTS**

Based on the perspective of accounting conservatism, this paper comprehensively analyzes the impact of the New Revenue Standard (centered on control transfer) on the quality of financial information. With the implementation of the New Standard, the criterion for revenue recognition has shifted from "transfer of risks and rewards" to "transfer of control". Undoubtedly, this change has improved the relevance of financial information, making financial statements more aligned with the economic substance of transactions and the actual operating conditions of enterprises. However, this reform has also brought about potential challenges, particularly regarding the expansion of management's discretionary space and the impact on accounting conservatism.

#### **4.1. Improvement in the Relevance of Financial Information**

By emphasizing "transfer of control" rather than "transfer of risks and rewards", the New Revenue Standard makes revenue recognition more consistent with the actual economic content of transactions. Compared with traditional methods, the control transfer model can more accurately reflect the economic activities and changes in control of enterprises in different transactions. This change enables financial information to better meet the needs of decision-making—especially in the handling of long-term contracts, variable consideration, and complex transactions—by providing a more timely and adaptable approach to revenue recognition. Therefore, relevance has been enhanced, and

financial statements can better serve as a basis for decision-making by investors, creditors, and other stakeholders.

#### **4.2. Expansion of Management's Discretionary Space and Reduction in the Reliability of Financial Information**

The increased flexibility and subjective judgment required by the New Standard have also brought potential risks. When recognizing revenue, management needs to make judgments based on factors such as contract content, performance obligations, and variable consideration. These judgments provide enterprises with more room for manipulation, which may lead to the advance or delay of revenue recognition timing, thereby affecting the reliability of financial statements. Enterprises may optimize the timing of revenue recognition to recognize revenue in advance and improve current financial performance. Such earnings management behaviors may distort financial reports, undermine the authenticity and reliability of financial information, and reduce the trust of statement users in the information.

#### **4.3. Dynamic Balance of Accounting Conservatism under the New Standard**

As the flexibility of revenue recognition increases, how to balance accounting conservatism with this flexibility has become a key issue. Accounting conservatism plays a crucial role in ensuring the reliability of financial information: it can effectively curb earnings management behaviors and ensure the prudence and rationality of revenue recognition. However, excessive conservatism may reduce the relevance of information, as overly conservative revenue recognition may fail to timely reflect the actual operating results of enterprises. Therefore, conservatism should be maintained at a dynamically balanced level. Ideal conservatism should not only effectively curb management's overly optimistic forecasts but also avoid the lag of financial information caused by excessive conservatism, thereby ensuring that financial information is both relevant and reliable.

#### **4.4. Multi-dimensional Impact on the Quality of Financial Information**

This paper further explores the multi-dimensional impact of the New Revenue Standard on the quality of financial information. The New Standard has obvious advantages in improving information relevance, but it may also bring the risk of information distortion—especially regarding the reliability, comparability, and understandability of information. Flexible revenue recognition may reduce the reliability and comparability of financial information; in particular, when different enterprises adopt different standards, it may make the comparison between financial statements more difficult. In addition, due to the increased need for management judgment, the understandability of financial statements may also be affected. Especially when enterprises fail to fully disclose details of revenue recognition, users may struggle to understand the basis and methods of revenue recognition. Therefore, although the New Standard has improved relevance, sufficient attention should be paid to its potential impact on other dimensions of financial information quality.

#### **4.5. Enterprises Should Strengthen Internal Controls and Information Disclosure**

Since revenue recognition under the New Standard involves more judgments and estimates, enterprises need to strengthen internal controls and information disclosure to ensure the transparency and rationality of the revenue recognition process. Particularly in terms of revenue recognition disclosure, enterprises should clearly explain the basis for revenue recognition, the classification of performance obligations, and the estimation methods for variable consideration. This will help investors, auditors, and regulatory authorities better understand the financial status of enterprises and enhance the credibility and transparency of financial statements.

In summary, through in-depth analysis of the implementation of the New Revenue Standard, this paper draws the following key conclusions: Although the New Revenue Standard has made significant progress in improving the relevance of financial information, its flexibility has also led to the expansion of management's discretionary space, thereby exerting a potential impact on the reliability of financial information. To ensure the quality of financial information—especially its reliability—enterprises should maintain an appropriate level of accounting conservatism when complying with the New Standard, and balance the relationship between flexibility and conservatism by strengthening internal controls and improving the transparency of information disclosure.

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