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Bachelor of Commerce (B2001) | Level 3 • Part B Major | Monash University

Advanced financial accounting

Course Code: ACC3100 • Module 3 Notes

Module 3: Share-Based Payments, Earnings Per Share, Segment Reporting & Related Parties

3.1 Share-Based Payments Architecture (*AASB 2*)

Executive and employee remuneration across ASX-listed corporations relies heavily on equity-linked incentives—including performance rights, zero-exercise-price options (ZEPOs), employee share purchase plans, and share appreciation rights (SARs). Historically, entities avoided recognising an expense when issuing options to executives because no cash left the company. *AASB 2 Share-based Payment* closed that reporting gap by requiring all entities to recognise the goods or services received in a share-based payment transaction at fair value, alongside a corresponding increase in equity or a liability.

For Australian disclosing entities, *AASB 2* operates in tandem with section 300A of the *Corporations Act 2001 (Cth)* and the ASX Listing Rules, which require detailed audited disclosures in the annual Remuneration Report regarding equity grants to Key Management Personnel (KMP), vesting hurdles, and fair values at grant date.

Classification of Share-Based Payment Transactions

AASB 2.2 classifies share-based payment arrangements into three categories based on settlement obligations:

1. **Equity-settled share-based payment transactions:** The entity receives goods or services as consideration for its own equity instruments (including ordinary shares, options, or performance rights, or equity instruments of its parent). The credit entry increases equity (typically a *Share-Based Payment Reserve*).
2. **Cash-settled share-based payment transactions:** The entity acquires goods or services by incurring a liability to transfer cash or other assets based on the price (or value) of the entity's equity instruments (for example, Share Appreciation Rights or phantom shares). The credit entry creates a liability remeasured to fair value at every reporting date until settlement.
3. **Transactions with cash alternatives:** Arrangements where either the entity or the counterparty has a choice of settling in cash or equity instruments (*AASB 2.34–43*). Where the counterparty holds the choice, the entity has issued a compound financial instrument containing a debt component and an equity component; where the entity holds the choice, it accounts for the arrangement as cash-settled only if a present obligation to settle in cash exists.

Measurement Hierarchy & Vesting Conditions

For transactions with **external parties (non-employees)**, *AASB 2.10* establishes a rebuttable presumption that the fair value of goods or services received can be measured reliably and therefore dictates measurement at the date the goods or services are obtained. For transactions with **employees and executives**, valuing incremental labour services directly is impracticable; consequently, *AASB 2.11* requires measurement indirectly by reference to the **grant-date fair value** of the equity instruments granted (determined using option pricing models such as Black-Scholes-Merton, binomial lattices, or Monte Carlo simulation).

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Critical to *AASB 2* expense recognition is distinguishing three types of conditions attached to an award:

Condition Category	Examples in Australian Practice	Treatment in Grant-Date Fair Value	Subsequent True-Up for Actual Outcomes?
Service Condition	Executive must remain continuously employed by the ASX entity for 3 years.	Excluded from grant-date fair value per instrument.	**Yes.** Estimate of number of awards expected to vest is updated at each reporting date and trued up to actual number vested.
Non-Market Performance Condition	Cumulative Earnings Per Share (EPS) growth ≥ 8% p.a., or Return on Invested Capital (ROIC) ≥ 12%.	Excluded from grant-date fair value per instrument.	**Yes.** Probability of meeting the hurdle is reassessed each period to estimate awards expected to vest; if hurdle is missed, cumulative expense reverses to zero.
Market Performance Condition	Relative Total Shareholder Return (TSR) at or above the 50th percentile of the S&P/ASX 200 index, or share price target ≥ A$15.00.	**Included** inside grant-date fair value (typically via Monte Carlo simulation, reducing fair value per right).	**No.** Never trued up if the market hurdle fails! Provided the employee completes the required service period, full grant-date expense remains recognised even if zero rights vest due to TSR failure.
Non-Vesting Condition	Employee must contribute to a savings plan, or post-vesting holding lock (selling restriction).	**Included** in grant-date fair value.	**No** true-up for non-vesting condition outcomes; failure to meet an employee-controlled non-vesting condition (e.g., ceasing monthly savings) is treated as a cancellation (immediate acceleration of remaining expense).

3.2 Equity-Settled vs Cash-Settled Share-Based Payments (Worked Examples)

For equity-settled awards subject to service and/or non-market performance conditions, the cumulative remuneration expense recognised from grant date to reporting date t over a vesting period of T years is:

$$E_{\text{cum},t} = N_{\text{est},t} \times FV_{\text{grant}} \times \frac{t}{T}$$

$$\Delta E_t = E_{\text{cum},t} - E_{\text{cum},t-1}$$

Where:

- $E_{\text{cum},t}$ = Cumulative share-based payment expense recognised up to the end of period t (in AUD).

- $N_{\text{est},t}$ = Best estimate at the end of period t of the total number of equity instruments expected to vest (reflecting updated forfeiture and non-market performance estimates; at vesting date $t = T$, $N_{\text{est},T}$ equals actual instruments vested).
- FV_{grant} = Grant-date fair value per equity instrument (locked at grant date for equity-settled awards).
- t/T = Proportion of the vesting period elapsed at reporting date t.
- ΔE_t = Remuneration expense recognised in profit or loss during period t (may be negative—a reversal—if vesting estimates drop sharply).

Worked Numerical Example 1: Equity-Settled Performance Rights with Changing Attrition & EPS Hurdle

Scenario: On 1 July 2025, **Southern Grid Energy Ltd** grants 2,000 performance rights (zero exercise price) to each of its 50 senior managers (100,000 rights total). Vesting occurs on 30 June 2028 (a 3-year vesting period) conditional on continuous employment and achieving a 3-year cumulative EPS target (a non-market performance condition). Grant-date fair value is A$12.00 per right. Because the rights carry an EPS hurdle and service condition, neither is embedded in FV_{grant}; both adjust $N_{\text{est},t}$.

- **Year 1 (30 June 2026):** 3 managers have resigned; management expects 4 more managers to leave before 30 June 2028 (43 managers expected to remain) and expects the EPS hurdle to be achieved.
  $N_{\text{est},1} = 43 \times 2,000 = 86,000$ rights.
  $E_{\text{cum},1} = 86,000 \times \text{AUD } 12.00 \times \frac{1}{3} = \text{AUD } 344,000.$
  Year 1 Expense: Dr Employee Benefits Expense A$344,000 / Cr Share-Based Payment Reserve (Equity) A$344,000.
- **Year 2 (30 June 2027):** 2 additional managers resigned (5 total departures to date); management now expects only 2 more departures (43 expected to remain), AND revises its forecast to conclude the EPS target will *only* be achieved at the 80% partial-vesting tier (1,600 rights per remaining manager), or let us assume all-or-nothing EPS target is still expected to be met by 44 managers (say 1 expected future departure: $N_{\text{est},2} = 44 \times 2,000 = 88,000$ rights).
  $E_{\text{cum},2} = 88,000 \times \text{AUD } 12.00 \times \frac{2}{3} = \text{AUD } 704,000.$
  Year 2 Expense = $\text{AUD } 704,000 - \text{AUD } 344,000 = \text{AUD } 360,000$: Dr Employee Benefits Expense A$360,000 / Cr Share-Based Payment Reserve A$360,000.
- **Year 3 (30 June 2028 — Vesting Date):** Total actual departures over the 3 years equal 8 managers, leaving 42 managers employed, and the EPS target is achieved.
  $N_{\text{actual}} = 42 \times 2,000 = 84,000$ rights vested.
  $E_{\text{cum},3} = 84,000 \times \text{AUD } 12.00 \times \frac{3}{3} = \text{AUD } 1,008,000.$
  Year 3 Expense = $\text{AUD } 1,008,000 - \text{AUD } 704,000 = \text{AUD } 304,000$: Dr Employee Benefits Expense A$304,000 / Cr Share-Based Payment Reserve A$304,000.

Notice what happens if instead the rights had carried a **relative TSR (market) hurdle** alongside the 3-year service condition, with grant-date Monte Carlo fair value of A$9.50 per right, and at 30 June 2028 all 42 managers remained employed but Southern Grid ranked at the 35th percentile so *zero* rights vested: cumulative expense would still remain $42 \times 2,000 \times \text{AUD } 9.50 = \text{AUD } 798,000$ and

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would **not** be reversed! Under *AASB 2.23*, once vested (or expired unexercised), the entity cannot reverse the credit in total equity, though it may transfer the balance from Share-Based Payment Reserve to Retained Earnings.

Worked Numerical Example: Modification (Repricing) of Equity-Settled Options (*AASB 2.27*)

Scenario: On 1 July 2025, **Apex Biotech Ltd** grants 50,000 share options to its CEO vesting on 30 June 2028 (3-year service condition). Exercise price = A$20.00; grant-date fair value = A$6.00 per option (total original grant value = A$300,000, or A$100,000 per year). By 1 July 2026 (end of Year 1, after A$100,000 expense is recognised), the ASX share price falls to A$11.00, leaving the options deeply underwater. To restore retention incentives, the board reprices the exercise price downward from A$20.00 to A$12.00. At the 1 July 2026 modification date, the fair value of the *original* A$20.00 option is A$1.80, whereas the fair value of the *modified* A$12.00 option is A$4.50.

- **Incremental Fair Value (*AASB 2.B43(a)*):** $FV_{\text{inc}} = \text{AUD } 4.50 - \text{AUD } 1.80 = \text{AUD } 2.70$ per option (total incremental value = $50,000 \times \text{AUD } 2.70 = \text{AUD } 135,000$). Note that the original grant-date fair value of A$6.00 is *never* reduced even though the option's value fell to A$1.80.
- **Allocation Over Remaining Vesting Period (Years 2 & 3):** The A$135,000 incremental fair value is spread evenly over the remaining 2 years ($\text{AUD } 67,500$ per year) in addition to the original $\text{AUD } 100,000$ per year:
  - Year 1 (FY2026): $\text{AUD } 100,000$ expense.
  - Year 2 (FY2027): $\text{AUD } 100,000 + \text{AUD } 67,500 = \text{AUD } 167,500$ expense.
  - Year 3 (FY2028): $\text{AUD } 100,000 + \text{AUD } 67,500 = \text{AUD } 167,500$ expense (cumulative total = A$435,000).

Modifications, Cancellations & Cash-Settled Share Appreciation Rights

When an entity modifies the terms of an equity-settled grant (for instance, repricing underwater options downward from an exercise price of A$10.00 to A$6.00), *AASB 2.27* requires recognising at minimum the original grant-date fair value expense, plus any **incremental fair value** (difference between the modified award's fair value and the original award's fair value, both measured at the modification date) spread over the remaining vesting period. Conversely, if an entity cancels an award during the vesting period (other than forfeiture), *AASB 2.28* treats the cancellation as an acceleration of vesting, requiring immediate recognition of the remaining unrecognised grant-date expense.

For **cash-settled share-based payments** (such as Share Appreciation Rights, SARs, entitling executives to receive cash equal to the share price increase over a reference price), the measurement model differs fundamentally: the liability is remeasured at **current fair value at each reporting date and settlement date**, with all changes recognised in profit or loss:

$$L_t = N_{\text{est},t} \times FV_{\text{SAR},t} \times \min\left(\frac{t}{T},\ 1\right)$$

Where:

- L_t = Carrying amount of the Cash-Settled Share-Based Payment Liability at reporting date t (in AUD).
- $N_{\text{est},t}$ = Estimated (or actual, post-vesting) number of SARs expected to vest or remaining unexercised.
- $FV_{\text{SAR},t}$ = Fair value per SAR at reporting date t (reflecting intrinsic value plus time value until exercise/expiry).
- t/T = Proportion of the vesting period completed (capped at $1 once vested; post-vesting fair value changes until exercise are recognised 100% immediately in P&L).

Worked Numerical Example 2: Cash-Settled Share Appreciation Rights (SARs)

Scenario: On 1 July 2025, **Coral Coast Logistics Ltd** grants 10,000 cash-settled SARs to its Chief Financial Officer, vesting on 30 June 2027 (2-year service period) and exercisable during FY2028. Expected retention is 100% throughout. Fair value per SAR is A$4.20 at 30 June 2026 and A$5.10 at 30 June 2027 (vesting date). On 15 December 2027, the CFO exercises all 10,000 SARs when intrinsic cash payout is A$5.60 per SAR (A$56,000).

Date	Calculation of Liability L_t & Period Expense	Journal Entry (Dr / Cr in A$)
30 Jun 2026	$L_1 = 10,000 \times \text{AUD } 4.20 \times \frac{1}{2} = \text{AUD } 21,000$ Year 1 Expense = A$21,000	Dr Employee Benefits Expense 21,000 Cr SAR Liability 21,000
30 Jun 2027	$L_2 = 10,000 \times \text{AUD } 5.10 \times \frac{2}{2} = \text{AUD } 51,000$ Year 2 Expense = $\text{AUD } 51,000 - \text{AUD } 21,000 = \text{AUD } 30,000$	Dr Employee Benefits Expense 30,000 Cr SAR Liability 30,000
15 Dec 2027	Final settlement value = $10,000 \times \text{AUD } 5.60 = \text{AUD } 56,000$ Post-vesting FV remeasurement = $\text{AUD } 56,000 - \text{AUD } 51,000 = \text{AUD } 5,000$	Dr Employee Benefits Expense 5,000 / Cr SAR Liability 5,000 Dr SAR Liability 56,000 / Cr Cash at Bank 56,000

3.3 Earnings Per Share: Basic & Diluted EPS (*AASB 133*)

Earnings Per Share (EPS) is among the most closely watched valuation metrics on the ASX, forming the denominator of the Price-to-Earnings (P/E) ratio. *AASB 133 Earnings per Share* applies to entities whose ordinary shares or potential ordinary shares are publicly traded (or in the process of being issued in a public market) and requires presentation of both **Basic EPS** and **Diluted EPS** with equal prominence on the face of the Statement of Profit or Loss and Other Comprehensive Income.



WANOS Weighting Timeline: Capital Structure Events Under AASB 133

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Basic EPS: Numerator & Weighted Average Number of Shares (WANOS)

Basic EPS measures the profit or loss for the period attributable to each ordinary share of the parent entity:

$$\text{Basic EPS} = \frac{NP_{\text{parent}} - D_{\text{pref}}}{WANOS}$$

Where:

- NP_{parent} = Consolidated profit or loss attributable to ordinary equity holders of the parent entity (specifically *after* deducting profit attributable to Non-Controlling Interests).
- D_{pref} = After-tax dividends on non-equity/equity-classified preference shares: for *cumulative* preference shares, deduct the full annual dividend entitlement whether declared or not (excluding arrears from prior years); for *non-cumulative* preference shares, deduct only dividends declared in respect of the period. (Note: if preference shares are classified as liabilities under *AASB 132*, their coupon is already deducted as interest expense inside NP_{parent} and is not deducted again.)
- $WANOS$ = Weighted average number of ordinary shares outstanding during the reporting period, weighted by the fraction of days or months each share tranche was outstanding.

When shares are issued for cash at full fair value (or via a share buy-back at market value), total entity resources change concurrently; therefore, WANOS is adjusted **prospectively** from the issue/cancellation date. By contrast, when shares are issued *without* a corresponding change in resources—such as a **bonus issue (share dividend)**, **share split**, or **reverse share split**—the proportionate ownership of existing shareholders does not change, so the share count is adjusted **retrospectively** to the beginning of the earliest period presented (meaning comparative prior-year Basic and Diluted EPS must also be restated).

A **rights issue** below market price is a hybrid event: part full-price share issue and part bonus element. Under *AASB 133.A2*, the bonus element is captured by multiplying all periods *prior* to the rights issue by the **Rights Adjustment Factor (**RAF**)**, derived from the **Theoretical Ex-Rights Price (**$TERP$**)**:

$$TERP = \frac{(N_{\text{cum}} \times P_{\text{cum}}) + (N_{\text{new}} \times P_{\text{sub}})}{N_{\text{cum}} + N_{\text{new}}}, \qquad RAF = \frac{P_{\text{cum}}}{TERP}$$

Where:

- $TERP$ = Theoretical Ex-Rights Price per share immediately after the rights issue (in AUD).
- P_{cum} = Fair value (closing ASX market price) per share immediately before exercise of rights (cum-rights price).
- P_{sub} = Subscription (exercise) price per new share under the rights issue ($P_{\text{sub}} < P_{\text{cum}}$).
- N_{cum} = Number of existing shares required to subscribe for N_{new} new shares (e.g., in a 1-for-4 rights issue, $N_{\text{cum}} = 4, N_{\text{new}} = 1$).

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- RAF = Rights Adjustment Factor applied retrospectively to share tranches outstanding prior to the rights issue (and to comparative prior-period EPS by dividing prior EPS by RAF).

Worked Numerical Example 3: Basic EPS with Share Issue, Bonus Issue & Rights Issue

Scenario: Tasman Infrastructure Ltd (ASX-listed, 30 June year-end) reported FY2026 consolidated profit after tax of A$9,400,000, of which A$600,000 is attributable to NCI. The company also has A$5,000,000 of 6% cumulative preference shares classified as equity (annual preference dividend = A$300,000, not yet declared at 30 June 2026). FY2025 Basic EPS originally reported was 82.0 cents.

Ordinary share movements during FY2026:

- 1 July 2025: 10,000,000 ordinary shares on issue.
- 1 October 2025: Issued 2,000,000 ordinary shares for cash at full market price.
- 1 January 2026: 1-for-6 bonus issue (increasing shares from 12,000,000 by 2,000,000 to 14,000,000 shares; bonus factor = $7/6$).
- 1 April 2026: 1-for-4 renounceable rights issue at $P_{\text{sub}} = \text{AUD } 3.50$ when the cum-rights ASX share price was $P_{\text{cum}} = \text{AUD } 4.50$ (issuing 3,500,000 new shares, bringing closing shares to 17,500,000).

Step 1: Basic EPS Numerator

$NP_{\text{parent}} - D_{\text{pref}} =$ (A$9,400,000 – A$600,000) – A$300,000 = **A$8,500,000** (cumulative preference dividend must be deducted even though undeclared).

Step 2: Calculate TERP & Rights Adjustment Factor

$$TERP = \frac{(4 \times 4.50) + (1 \times 3.50)}{4 + 1} = \frac{21.50}{5} = \text{AUD } 4.30, \qquad RAF = \frac{4.50}{4.30} \approx 1.046512$$

Step 3: Compute WANOS Across Time Intervals

Period	Shares on Issue	Time Weight	Retrospective Factors (Bonus × RAF)	Weighted Shares
1 Jul – 30 Sep 2025	10,000,000	$3/12$	$(7/6) \times (4.50/4.30)$	$10,000,000 \times \frac{3}{12} \times \frac{7}{6} \times \frac{4.50}{4.30} = 3,052,326$
1 Oct – 31 Dec 2025	12,000,000	$3/12$	$(7/6) \times (4.50/4.30)$	$12,000,000 \times \frac{3}{12} \times \frac{7}{6} \times \frac{4.50}{4.30} = 3,662,791$
1 Jan – 31 Mar 2026	14,000,000	$3/12$	$1 \times (4.50/4.30)$	$14,000,000 \times \frac{3}{12} \times \frac{4.50}{4.30} = 3,662,791$
1 Apr – 30 Jun 2026	17,500,000	$3/12$	1×1	$17,500,000 \times \frac{3}{12} = 4,375,000$

Period	Shares on Issue	Time Weight	Retrospective Factors (Bonus × RAF)	Weighted Shares
Total WANOS	—	**12/12**	—	**14,752,908 shares**

Step 4: Basic EPS & Restated Comparative EPS

- FY2026 Basic EPS = $\frac{\text{AUD } 8{,}500{,}000}{14{,}752{,}908} = \text{AUD } 0.5762 = \mathbf{57.6}$ cents per share.
- Restated FY2025 Comparative Basic EPS = $\frac{82.0 \text{ cents}}{(7/6)\times(4.50/4.30)} = \mathbf{67.2}$ cents per share.

Diluted EPS: Potential Ordinary Shares & Incremental Ranking Test

Diluted EPS reflects the worst-case dilution from **Potential Ordinary Shares (POS)**—financial instruments or contracts (such as options, warrants, convertible notes, convertible preference shares, and employee share rights) that may entitle their holders to ordinary shares. Under *AASB 133.41–44*, POS are included in Diluted EPS *only if they are dilutive* (meaning their assumed conversion/exercise decreases EPS or increases loss per share from continuing operations); **anti-dilutive POS are strictly excluded**.

Two distinct computational methods apply:

1. **Treasury Stock Method (Options & Warrants):** Assumes options are exercised at the start of the period (or grant date if later) and that the proceeds received (exercise price plus any unrecognised *AASB 2* fair value of future employee services) are used to repurchase ordinary shares at the *average market price* during the period (P_{avg}). Only the net "free" shares (ΔN_{opt}) increase the denominator, with zero impact on the numerator (hence options are dilutive whenever $P_{\text{avg}} > K_{\text{eff}}$):

   $$\Delta N_{\text{opt}} = N_{\text{opt}} \times \left(\frac{P_{\text{avg}} - K_{\text{eff}}}{P_{\text{avg}}}\right)$$

   Where: ΔN_{opt} = incremental dilutive shares added to WANOS; N_{opt} = number of options under contract; P_{avg} = average market price of ordinary shares during the period; K_{eff} = effective exercise price (cash strike price plus unrecognised grant-date *AASB 2* fair value per option).

2. **If-Converted Method (Convertible Notes & Convertible Preference Shares):** Assumes conversion into ordinary shares at the beginning of the period (or issue date if later). The denominator increases by the maximum shares issuable on conversion (ΔN_{conv}), while the numerator increases by the after-tax interest expense saved on convertible notes ($I \times (1 - \tau)$) or the preference dividend saved (D_{pref}).

When multiple POS classes exist, *AASB 133.44* requires ranking them from **most dilutive to least dilutive** based on **Earnings Per Incremental Share (**$EPIS = \Delta\text{Earnings}/\Delta\text{Shares}$**)** and testing them sequentially against running Diluted EPS:

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Worked Numerical Example 4: Diluted EPS Ranking & Anti-Dilution Exclusion

Scenario: Southern Cross Tech Ltd (tax rate $\tau = 30\%$) reports FY2026 net profit attributable to ordinary shareholders of A$4,200,000 and Basic WANOS of 2,000,000 shares (Basic EPS = $\text{AUD } 4,200,000/2,000,000 = \text{AUD } 2.10$). Average market share price during FY2026 was $P_{\text{avg}} = \text{AUD } 25.00$. Three POS instruments were outstanding for the full year:

1. **Executive Options:** 300,000 options exercisable at A$15.00 each (all vested; unrecognised *AASB 2* service cost = A$0).
2. **Convertible Bonds (6%):** A$5,000,000 face value (annual pre-tax interest = A$300,000), convertible into 250,000 ordinary shares.
3. **Convertible Preference Shares (8%):** A$4,000,000 equity-classified preference shares (annual preference dividend = A$320,000, already deducted in arriving at A$4,200,000), convertible into 120,000 ordinary shares.

Step 1: Compute EPIS for Each POS Class

- **Options:** $\Delta N_{\text{opt}} = 300,000 \times \frac{25-15}{25} = 120,000$ shares; $\Delta\text{Earnings} = \text{AUD } 0$; $EPIS = \text{AUD } 0/120,000 = \text{AUD } \mathbf{0.00}$ (Rank 1 — always most dilutive if in-the-money).
- **6% Convertible Bonds:** $\Delta\text{Earnings} = \text{AUD } 300,000 \times (1 - 0.30) = \text{AUD } 210,000$; $\Delta N = 250,000$ shares; $EPIS = \text{AUD } 210,000/250,000 = \text{AUD } \mathbf{0.84}$ (Rank 2).
- **8% Convertible Preference Shares:** $\Delta\text{Earnings} = \text{AUD } 320,000$ (dividends are not tax-deductible); $\Delta N = 120,000$ shares; $EPIS = \text{AUD } 320,000/120,000 = \text{AUD } \mathbf{2.67}$ (Rank 3).

Step 2: Sequential Dilution Waterfall

Step / Instrument	Cumulative Numerator (A$)	Cumulative Shares	Running EPS (A$)	Decision
Basic EPS (Baseline)	4,200,000	2,000,000	2.100	Baseline
+ Rank 1: Executive Options ($EPIS = 0.00$)	4,200,000	2,120,000	1.981	$0.00 < 2.100 \implies$ **Dilutive (Include)**
+ Rank 2: 6% Convertible Bonds ($EPIS = 0.84$)	4,410,000	2,370,000	1.861	$0.84 < 1.981 \implies$ **Dilutive (Include)**
+ Rank 3: 8% Convertible Pref Shares ($EPIS = 2.67$)	4,730,000	2,490,000	1.900	$2.67 > 1.861 \implies$ **Anti-dilutive (Exclude)**

Southern Cross Tech Ltd therefore reports **Basic EPS of A$2.10** (210.0 cents) and **Diluted EPS of A$1.86** (186.1 cents), excluding the convertible preference shares because their incremental EPS of A$2.67 exceeds running diluted EPS of A$1.861.

3.4 Operating Segments (*AASB 8*)

Consolidated financial statements aggregate diverse businesses into single totals, masking divergent growth rates, margins, and risk profiles across industries or geographies. *AASB 8 Operating Segments* (aligned with IFRS 8) mandates disaggregated reporting by listed entities under a **management approach**—requiring companies to report segment data through the eyes of internal management rather than forcing artificial industry classifications.

An **operating segment** (*AASB 8.5*) is a component of an entity: (a) that engages in business activities from which it may earn revenues and incur expenses; (b) whose operating results are regularly reviewed by the entity's **Chief Operating Decision Maker (CODM)** (for example, the Managing Director/CEO or Executive Committee) to make resource allocation decisions and assess performance; and (c) for which discrete financial information is available.

Aggregation Criteria & Quantitative Thresholds

Two or more operating segments may be aggregated into a single operating segment under *AASB 8.12* only if aggregation is consistent with the core principle of the standard, the segments share similar economic characteristics (such as similar long-term gross margins), and they are similar across all five qualitative dimensions: nature of products/services, nature of production processes, type or class of customer, distribution methods, and regulatory environment.

To prevent immaterial clutter, *AASB 8.13–15* requires separate disclosure of a **reportable segment** whenever an operating segment (or aggregated group) satisfies *any one* of three 10% quantitative thresholds, followed by an overall 75% external revenue check:

1. **10% Revenue Test:** Combined external and intersegment revenue is $\geq 10\%$ of the combined revenue (external plus intersegment) of *all* operating segments.
2. **10% Profit or Loss Test:** The absolute amount of reported profit or loss is $\geq 10\%$ of the *greater*, in absolute amount, of: (i) the combined reported profit of all operating segments that did not report a loss, and (ii) the combined reported loss of all operating segments that reported a loss.
3. **10% Assets Test:** Segment assets are $\geq 10\%$ of the combined assets of all operating segments.
4. **75% External Revenue Sufficiency Test:** Total *external* revenue reported by reportable segments must equal at least 75% of the entity's total consolidated revenue. If below 75%, additional operating segments (even below 10%) must be designated as reportable until at least 75% is reached; remaining segments are combined into an "All other segments" category.

Worked Numerical Example 5: Operating Segment Threshold Testing

Scenario: Pacific Diversified Ltd (ASX-listed) has five operating segments reviewed by its CEO (the CODM). Internal segment data (in A$ millions) for FY2026 is summarised below:

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Segment	External Rev (A$m)	Intersegment Rev (A$m)	Total Rev (A$m)	Segment Profit / (Loss) (A$m)	Segment Assets (A$m)	10% Tests Met & Status
Mining Services	420	30	450	65	520	Rev (45%), Profit (60%), Assets (43%) → **Reportable**
Civil Engineering	280	20	300	35	380	Rev (30%), Profit (32%), Assets (32%) → **Reportable**
Renewable Energy	70	0	70	(18)	140	Assets ($140 \geq 120$) & Loss ($\lvert -18 \rvert \geq 10.8$) → **Reportable**
Logistics	80	30	110	8	90	Total Rev ($110 \geq 100$) → **Reportable**
Corporate Advisory	60	10	70	(4)	70	Rev 7%, Loss 3.7%, Assets 5.8% → *Below 10%*
Totals	**910**	**90**	**1,000**	**+108 / (22)**	**1,200**	—

- **Revenue Threshold:** $10\% \times \text{AUD } 1,000\text{m} = \text{AUD } 100\text{m}$ (Mining Services, Civil Engineering, and Logistics pass).
- **Profit/Loss Threshold:** Greater of $\lvert +65+35+8 \rvert = 108$ and $\lvert -18-4 \rvert = 22$ is AUD 108m; $10\% \times 108 = \text{AUD } 10.8\text{m}$ (Mining Services, Civil Engineering, and Renewable Energy pass—note Renewable Energy passes on loss despite Logistics having higher external revenue!).
- **Assets Threshold:** $10\% \times \text{AUD } 1,200\text{m} = \text{AUD } 120\text{m}$ (Mining Services, Civil Engineering, and Renewable Energy pass).
- **75% External Revenue Check:** Sum of external revenue of the four reportable segments = $420+280+70+80 = \text{AUD } 850\text{m}$. Compared to consolidated external revenue of AUD 910m: $850/910 = 93.4\% \geq 75\%$. The 75% test is satisfied, so Corporate Advisory is grouped into "All other segments".

Because segment measures reflect internal management reporting (which may exclude corporate head-office overheads, fair value adjustments, or AASB 16 lease allocations), *AASB 8.28* mandates explicit numerical **reconciliations** from total reportable segment revenues, profit/loss, assets, and liabilities to the entity's consolidated financial statement totals. Even single-segment entities must provide

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entity-wide disclosures (*AASB 8.31–34*) covering revenues by product/service, geographical revenues and non-current assets (Australia vs foreign countries), and reliance on any single external customer accounting for $\geq 10\%$ of total revenue.

3.5 Related Party Disclosures (*AASB 124*)

Financial statements ordinarily presume transactions occur at arm's length between independent, self-interested parties. Transactions with related parties—such as controlling shareholders, directors, executive officers, associates, or entities controlled by family members—can occur on preferential or off-market terms (interest-free loans, discounted asset transfers, management fees, or guarantees) or even alter commercial relationships simply through the existence of the relationship. *AASB 124 Related Party Disclosures* ensures users receive transparent information about related party relationships, transactions, and balances.

Identifying Related Parties (*AASB 124.9*)

A related party is either a *person* or an *entity* related to the reporting entity:

- **Related Persons and Close Family Members:** A person (or a close member of that person's family—spouse/domestic partner, children, dependants) is related to the reporting entity if that person: (i) has control or joint control of the reporting entity; (ii) has significant influence over the reporting entity; or (iii) is a member of the **Key Management Personnel (KMP)** of the reporting entity or of a parent of the reporting entity.
- **Related Entities:** Include members of the same consolidated group (parent, subsidiaries, fellow subsidiaries), associates and joint ventures of the entity (or of its group members), post-employment benefit plans (such as corporate superannuation funds for employees), entities controlled or jointly controlled by a related person, and entities over which a person with control/joint control of the reporting entity has significant influence or serves as KMP.

Importantly, two entities are *not* related parties merely because they share a common director or KMP, nor are two venturers merely because they share joint control over a joint venture, nor are providers of finance, trade unions, or government departments simply by virtue of normal commercial dealings.

Mandatory Disclosures & Australian KMP Alignment

AASB 124 mandates four core disclosure pillars:

1. **Parent-Subsidiary Relationships (*AASB 124.13*):** Name of the parent and, if different, the ultimate controlling party must be disclosed *regardless* of whether any transactions occurred between them during the period.
2. **Key Management Personnel (KMP) Compensation (*AASB 124.17*):** Total compensation paid or payable to KMP (directors and senior executives with authority and responsibility for planning, directing, and controlling activities) must be disclosed in aggregate and broken down into five categories: (a) short-term employee benefits (cash salary, annual leave, short-term bonuses, non-monetary fringe benefits); (b) post-employment benefits (superannuation contributions); (c) other long-term benefits (long service leave); (d) termination benefits; and (e) share-based payments (*AASB 2* expense). In Australia, disclosing entities additionally provide individual KMP

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remuneration tables in the Directors' Report under section 300A of the *Corporations Act 2001 (Cth)* and *AASB 124.Aus29.1*.

3. **Transactions and Outstanding Balances (*AASB 124.18–24*):** For all related party transactions (grouped separately by category: parent, subsidiaries, associates, joint ventures, KMP, other related parties), entities must disclose the nature of the relationship, transaction amounts, outstanding balances (including commitments), terms and conditions (whether secured, nature of consideration), guarantees given/received, and any allowance for expected credit losses (*AASB 9*) or bad debt expense recognised during the period. Entities may state that related party transactions were made on arm's length terms *only if such terms can be substantiated*.
4. **Government-Related Entities Exemption (*AASB 124.25–27*):** Because Australian state and federal governments control numerous utilities, transport agencies, and public corporations (such as Australia Post or state energy networks), full transaction disclosures between every government-controlled entity would be overwhelming. *AASB 124.25* exempts government-related entities from detailed transaction disclosures with the government and fellow government entities, requiring instead the name of the government, nature of relationship, and nature/amount of any individually or collectively significant transactions.

Contingently Issuable Shares & Special *AASB 133* Rules

In corporate acquisitions (earn-outs) and executive performance rights plans, entities frequently commit to issue ordinary shares contingent upon future events such as achieving an earnings target or share price hurdle. Under *AASB 133.24*, contingently issuable shares are included in **Basic EPS** only from the date when all necessary conditions have been satisfied (i.e., when the shares are no longer contingent). By contrast, in **Diluted EPS** (*AASB 133.52–57*), contingently issuable shares are included from the beginning of the period (or grant date if later) if the conditions would be satisfied assuming the end of the reporting period were the end of the contingency period—for instance, if a 3-year cumulative EBITDA target is already met on a pro-rata or trailing basis at balance date. If the entity reports a **loss from continuing operations**, potential ordinary shares are always anti-dilutive because increasing the denominator reduces the loss per share; consequently, Diluted EPS equals Basic EPS during loss years (*AASB 133.41*).

Illustrative KMP & Related Party Disclosure Schedule (*AASB 124* & *Corporations Act* s 300A)

The table below illustrates the standard Australian financial statement note reconciling aggregate KMP remuneration under *AASB 124.17* alongside related party transactions:

Disclosure Category (Note 28: Related Parties)	FY2026 (A$)	FY2025 (A$)	Statutory & Standard Basis
Short-term employee benefits (cash salary, STI, non-monetary)	3,420,000	3,180,000	*AASB 124.17(a)*
Post-employment benefits (superannuation guarantee & contributions)	265,000	248,000	*AASB 124.17(b)*

Disclosure Category (Note 28: Related Parties)	FY2026 (A$)	FY2025 (A$)	Statutory & Standard Basis
Other long-term benefits (long service leave movement)	84,000	72,000	*AASB 124.17(c)*
Termination benefits	0	150,000	*AASB 124.17(d)*
Share-based payments (*AASB 2* performance rights & options)	1,190,000	960,000	*AASB 124.17(e)*
Total Key Management Personnel Compensation	**4,959,000**	**4,610,000**	**Reconciled to Remuneration Report (s 300A)**
Sales of engineering services to Associates (arm's length terms)	1,850,000	1,420,000	*AASB 124.18–19(d)*
Lease payments to entity controlled by Non-Executive Director	420,000	405,000	*AASB 124.18–19(f)*
Unsecured loan receivable from Associate (at 6.5% p.a., due 2028)	750,000	900,000	*AASB 124.18(b)* (ECL allowance: A$0)

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