

SSE plc
Alternative Performance Measures (APMs)
July 2020

Introduction

As referred to on page 164 of its 2020 Annual Report and Accounts (ARA), SSE uses APMs to internally monitor financial performance and to ensure a consistent and ongoing basis for transparent external reporting of profit (and earnings), capital expenditure and debt metrics. By excluding exceptional (and other defined) items and movements on the mark-to-market valuation of derivative financial instruments from its APMs, SSE reports its periodic financial performance metrics on a defined, consistent and understandable basis. The 'Alternative Performance Measures' section of SSE's ARA explains the purpose and basis of each APM and provides a detailed reconciliation from the equivalent reported measure. The Group's policy on exceptional items is explained in Note 3.2 to the financial statements on page 180 of the ARA 2020. In determining its APMs and the disclosures, presentation, reconciliations, explanations and prominence thereof, SSE has taken account of relevant guidance published by ESMA (European Securities and Markets Authority). In addition, in relation to the impact of the Coronavirus on the 2020 results, SSE considered guidance published by the Financial Reporting Council in May 2020.

Specific additional comments on application

In order to be as transparent as possible in relation to its use of APMs, SSE has included significant additional disclosures in the ARA sections referred above. To expand further on this, the following notes explain in more detail the rationale behind the accounting judgements on certain issues reported as part of SSE's results for FY19/20.

1) Depreciation and amortisation charges on fair value uplifts

As explained on page 166 of the ARA2020, on loss of control following the sale of a stake in an investment or business, SSE is required under IFRS 11 to record a 'fair value uplift' in relation to its revalued holding in the now equity accounted joint venture. This unrealised income statement gain will be excluded from SSE's profit (and earnings) APMs and accordingly any associated depreciation or amortisation charge arising from that fair value adjustment will also be excluded from future APMs.

Separately, SSE is required to review the carrying value of non-current assets, for example Property, Plant and Equipment, annually for signs of impairment such as a deterioration in operating performance or in market conditions. Where such signs exist, an impairment test will be conducted. An impairment charge will then be recorded should the carrying (book) value of the asset exceed the fair value of the asset. The fair value will be based on net cash flows expected to be earned from the asset over its remaining expected useful life. Further commentary on the policy is noted at page 247 of the ARA 2020. This is one of SSE's significant financial judgements as specifically referred to in both the Audit Committee Report and the report of the external auditor to SSE's shareholders.

Where the impairment charge for a single asset exceeds £30m, the charge is deemed to be exceptional and hence will be excluded from SSE's APMs. For the avoidance of doubt, there is no ability to reinstate a notional depreciation charge associated with historically impaired assets.

2) Treatment of internal hedge contracts associated with Gas Production

In FY19/20, SSE classified its investment in its Gas Production assets as being 'held for sale' under IFRS 5. Under the appropriate fair value measurement basis ('fair value less costs to sell') and noting the structure of the expected sale, the carrying value of the held for sale assets were impaired by £291.3m, which was reported as an exceptional charge in discontinued operations.

The anticipated deal structure is of particular importance in two regards; i) the economic date of the transaction is expected to be 1 April 2019 with net cash flows from that date accruing to the prospective buyer and ii) the assets are being sold 'unhedged' – i.e. the net cash flows from 1 April 2019 exclude the benefit of hedge contracts entered into by the Gas Production business with SSE's EPM function. The value of those hedge contracts retained by SSE in FY19/20 was £77.1m. This value was reported as part of SSE's continuing operations with the unhedged result from Gas Production reported as part of discontinued operations.

3) Coronavirus-related exceptional charges

On 20 May 2020, the Financial Reporting Council (FRC) issued guidance to companies in relation to the impact of the Covid-19 pandemic on Corporate Governance and Reporting. Included in that guidance was express commentary on companies' use of exceptional or similar items and APMs. The guidance noted that companies should consider the separate disclosure of the impact of Covid-19 on their results and contained specific advice on how to make those determinations. Following its consideration of the impacts on the business and emerging practice from other companies, SSE identified that a discrete element of the Covid-19 impact to its FY19/20 results – namely the incremental impairment of customer debt – should be considered exceptional and reported separately. Disclosures explaining the rationale for and impact of this treatment were included at pages 164, 180, 181 and 200 in the ARA 2020.

4) Extension of onshore wind asset lives

Following a detailed technical review of the useful economic lives of its onshore wind farms, SSE extended their estimated lives from 20 to 25 years. This change in accounting estimate aligned SSE more closely with industry practice and had the impact of increasing profit before tax by £30.2m in FY19/20. Disclosure explaining this change in accounting basis was included on page 176 of the ARA2020. This change, and its impact on current year profit was also highlighted in the November 2019 Interim Statement. Had SSE adopted this accounting policy change earlier, a similar equivalent increase would have been recorded in the FY18/19 financial statements. SSE is required to review its depreciation policies annually and any changes thereof – including extension to or reduction in useful life estimates – are prima facie non-exceptional.

Conclusion

SSE takes seriously its transparency in reporting financial performance and will continue to monitor developing practice in the use of Alternative Performance Measures and will continue to prioritise this, ensuring the financial information in its ARA is clear, consistent and relevant to the users of the ARA.