PUB-IC-7 **On pg. 20 Ms. Lee states that Hydro's proposal to use a group depreciation concept in the determination of life characteristics and apply that average life to each asset within the group is fundamentally incorrect. However, she also appears to agree that Hydro's proposal will result in a similar level of depreciation expense as would result if the remaining life is applied to the total plant in the group or account. Is this a correct statement of Ms. Lee's position? If it is, confirm there is no material difference in depreciation expense with either of the two approaches. If not, explain why not.**

RESPONSE: Assuming the group life is the appropriate life for each individual asset within the group, then yes the depreciation expenses resulting from application to each individual asset will be the same as those produced by application to the total account investment. However, the assumption that an average life determined for the entire account is appropriate to apply to each asset is not appropriate. The fundamental concept of group depreciation is that items within the group will live longer or shorter than the average life. The average life is just that – it's an average based on lives for all assets within the account. Lives for items within an account can range from 5 years to 50 years with an average life to the group of 30 years. Group depreciation is used because of its simplicity of using averages. Application of averages to unit depreciation is not in line with generally accepted depreciation practices or procedures.

Additionally in retrospect, given the Company's position of ceasing depreciation on assets within the group that it contends are fully depreciated, then the depreciation expense on the remaining individual assets will not be the same as if the depreciation expense were calculated on the total account or group

investment basis. For example, an account total investment is $10,000. Assume for the sake of argument, assets totaling $1,000 become fully depreciated even though they continue providing service. As Ms. Lee understands the Company's position, since $1,000 is fully depreciated it no longer receives depreciation expense. The depreciation expense is only calculated on investment of $9,000 not the $10,000 of total in-service investment. This assumes, on an account basis, that $1,000 has retired but, in reality, it continues to provide service. Thus, depreciation expense calculated on each unit is not necessarily the same as depreciation calculated on the total group account basis. Ms. Lee believes there can be a material difference between calculating depreciation expense on the total account investment versus Hydro's approach of ceasing depreciation on assets contained in the account that are fully depreciated but continue to provide service.