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SUBJECT: ACCOUNTING FOR CAPITAL ASSETS

I. PURPOSE

The purpose of this regulation is to establish uniform policies and procedures for the control of City-owned property, herein defined as capital assets.

As used in this Administrative Regulation (AR), the term "property" is synonymous with "capital assets".

II. SCOPE

This regulation is applicable to all City departments and offices under the direction of the City Manager. This regulation is also applicable to all contracted entities or independent contractors that manage or oversee the display, inventory and safekeeping of City-owned assets.

In the interest of administrative uniformity, it is recommended that City elected offices and other independent offices and departments of the City comply with these procedures.

III. HISTORY

This policy supersedes Administrative Regulation 16-1 in its entirety.

IV. AMENDMENT

The City Manager may edit or update the policy, procedures and contents in this regulation in accordance with the provisions set forth in Financial Policy and Procedure (FPP) 1-1.

V. POLICY

A) The City shall maintain capital asset records of public property. Capital assets must be accounted for in accordance with Generally Accepted Accounting Principles (GAAP) and other Governmental, trust, or contractual requirements.

B) Capital Assets Classifications

1. **Land** Land is non-expendable, real property. Capitalization cost includes the cost of land itself and the cost of preparing land for its intended use. These costs include search costs, legal fees, liens assumed, taxes assumed, grading costs, and land improvements with an indefinite life.

2. **Buildings** All permanent structures used for operating purposes. The cost of building must include all components and additions that comprise the basic structure or function to service the building. All expenses necessary to put a building or structure in its intended state of operations will be capitalized, including:

- a) Purchase or construction cost
- b) Professional fees (e.g. architects, attorneys, appraisers, etc.)
- c) Building permits

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- d) Interest on indebtedness
- e) Fixed equipment building components (e.g. lighting, electrical systems, plumbing, air conditioning, elevators, etc.) will be capitalized with the cost of the building project and will include acquisition, transportation and installation charges.

Significant structural changes to a building that increases the building's usefulness, efficiency or asset life also should be accounted for and added to its value.

3. **Improvements other than buildings** Permanent improvements, other than buildings, that add value to land, but do not have an indefinite useful life. Examples include fences, retaining walls, parking lots, and most landscaping.
4. **Machinery and equipment** This major class is used for vehicles, office equipment, machinery, furnishings, and similar moveable items. Acquisition cost includes purchase price, freight charges and installation. This class of asset will be capitalized if the acquisition cost per item is \$10,000 or more (\$5,000 or more for assets acquired with federal grant monies).
5. **Infrastructure Capital** Assets that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets. Examples include roads, bridges, drainage systems, water and sewer systems, traffic signals, and lighting systems.
6. **Construction in Progress** This major class of assets is used for costs incurred to construct or develop a capital asset before it is substantially ready to be placed into service, at which time the asset would be reclassified into the appropriate major class.
7. **Other capital assets** This major class of capital assets is available to all items not properly included in one of the other major classes.

C) Definitions

1. **Capital assets** are land, buildings, improvements other than buildings, equipment, works of art and historical treasures, and all other tangible and intangible assets that are used in operations, have initial useful lives extending beyond a single reporting period and the cost of acquisition meets or exceeds the capitalization threshold amounts per this policy. They are purchased, developed, constructed or acquired with City money, including grant funds, trust monies and debt proceeds, or are acquired as a result of contributions or donations made to the City.
2. **Acquisition Cost** is defined as costs incurred to purchase, construct, improve, or develop a capital asset. These costs include any freight or shipping charges, closing costs, legal and title fees, appraisal and negotiation fees, sales tax, installation costs, demolition costs, and site preparation costs, less any trade-in value. Initial or subsequent training on the use of an asset should never be capitalized

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3. **Depreciable capital assets** are those assets that decline in service potential or value over time (i.e. assets that have an estimable useful life) and include, but are not limited to, buildings and other structures, improvements other than buildings, machinery &, equipment, and major software systems.
4. A **Capital Project** is a capitalizable activity that either results in the creation of a new capital asset, the lengthening of the estimated useful life of an existing capital asset, or the increase in the service capacity of an existing capital asset.
5. **Non-depreciable capital assets** are capital assets that include construction-in-process, land, easements, works of art, and historical artifacts and are not depreciated or amortized because (1) they are not yet substantially ready to be placed into service or (2) they have an indefinite useful life. There is no capitalization threshold for non-depreciable assets.
6. **Walk-away items** are non-capitalized assets (i.e. do not meet capitalization threshold criterion) that are generally small, mobile, and easily converted to personal use, having a street value or fair market value of at least \$250 but less than \$10,000. The department must track walk-away items. Examples of walk-away items include, but are not limited to, firearms, video equipment, two-way radios, cameras, GPS units, smart phones, facsimile machines, PDAs, computers, laptops, computer peripherals, printers, and power tools. Walk-away items do not include conference room tables, chairs, bookcases, sports equipment, etc.
7. **Assets held for Resale** are financial assets, not capital, since they are acquired for the express purpose of sale rather than use in governmental operations. A common example is redevelopment property where land is acquired in an economically depressed area for the purpose of development and subsequent resell to private sector purchaser. These assets are not reported in FAACS, but instead are reported in the City's Financial Accounting Management Information System (**FAMIS**) as "Land Held for Resale".
8. A **Custodian** is an entity or independent contractor with whom the City has a contractual agreement to manage or oversee the display, inventory and safekeeping of City-owned assets of historical or cultural significance. Departments who oversee or contract with a custodian are responsible for the custodian's adherence to the applicable portions of this AR.
9. A **Property Control Officer** is [C.E.1]a City employee who has been designated by the Department to make additions, transfers, retirements and changes in the department's property records as well as being responsible for ensuring the performance of the annual physical inventory as described in this regulation.

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10. A **Project Control Manager** is [C.E.2]a City employee who has been designated by the Department to capitalize projects in the City capital asset system, including determination when asset has been put in use and the proper classification and life of asset.
11. **Capitalized Interest** is interest incurred during the process of acquiring a capital asset that is included as part of the asset's cost (Proprietary Funds only).
12. A **Capital Lease** is an agreement that conveys the right to use property, plant or equipment, usually for a stated period of time, that meets one or more of the following criteria:
 - The lease transfers ownership at the end of the lease term.
 - There is a bargain purchase option.
 - The lease term is at least 75% of the asset's useful life.
 - The present value of the minimum lease payments is at least 90% of the fair market value of the asset.
13. An **Impairment** is a significant and unexpected decrease in the service utility of a capital asset.

D) Capitalization

The minimum capitalization threshold for newly purchased, contributed or donated depreciable capital assets, excluding capital projects, is \$10,000 (\$5,000 for assets acquired with federal grant monies). An asset meeting this threshold (which includes freight, sales tax, installation charges, and trade-in value) must be charged to a capital outlay subobject code in the Financial System and recorded as a capital asset in the Fixed Asset Accounting and Control System (FAACS).

The minimum capitalization threshold for a capital project is \$100,000. A capital project must be charged to a project account in the Financial System and recorded as a capital asset in FAACS when placed into service.

- E) Improvements versus Repair and Maintenance – Expenditures made to retain an existing asset's value or maintain or restore an asset's working condition are repair and maintenance and are not capitalized. Examples include slurry seals on streets and alleyways and roofs to buildings.
- F) Cost for internally developed or constructed assets – Costs associated with internally developed or constructed assets are capitalized only after the specific objective of the project has been determined and feasibility is successfully completed. GAAP prohibits the capitalization of costs incurred during preliminary project stage development. In addition, general and administrative costs (i.e. office facilities, executive management,

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human resources, accounting) should not be capitalized. Cost clearly related to acquisition/development/construction of capital assets, but not to a specific project (indirect cost) should be capitalized. These cost include design, project oversight, and cost accounting.

G) Grant Funded Capital Assets – City departments and offices are required to adhere to respective grant regulations, contracts or trust documents for all assets acquired with grant or trust monies. Assets acquired with Federal Grant monies shall be capitalized if cost is \$5,000 or greater.

H) Accountability

1. The City's capital assets will be recorded in FAACS, which tracks costs, estimated useful life, depreciation, and other pertinent information about the property.
2. Department heads, managers, property control officer/manager, and custodians are responsible for safeguarding the City's assets under their purview. They are also required to maintain proper records to document the assets' location as well as providing ongoing care and maintenance to enhance and preserve the assets' overall useful life.
3. A Custodian shall notify the Property Control Officer of the responsible department immediately of any loss, theft, damage, or impairment to any assets under their scope of responsibility or control. The notification shall then be submitted to the Department of Financial Management and the City Auditor. The Custodian is solely responsible to ensure the repair of damage to assets not due to normal wear and tear of the asset. In addition the Custodian shall comply with grantor and trust regulations when grant or trust monies fund asset procurement.
4. Specific employees, designated Property Control Officers, must be assigned responsibility for property control, which includes additions, transfers, retirements and changes in their department's property records, and ensuring the performance of the annual physical inventory as described in this regulation.

Specific employees, designated Project Control Managers, must be assigned responsibility for capital project control, which includes identification when projects are put in use and proper asset classification.

Departments shall submit the following information related to the assignment of an employee or employees as the department's Property Control Officer(s) and Project Control Manager(s) to the Department of Financial Management, Accounting Bureau, by June 30 of each year:

- o Name
- o Position

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- Phone Number
 - Email Address
5. The City's Property Agent, (currently Technology Services Department, Administrative Officer) shall determine the final disposition of retired assets.
 6. Department of Public Works, Property Services Bureau, shall review real property purchases and sales. The City Council must approve all real property sales before they are executed. Determination of whether land is a capital asset or "Land Held for Resale" is made at the time of acquisition in line with City Council's intent. The intent can be changed at a later date and requires notification to Financial Management.
 7. Assets, not considered to be Walk-away items, which cost less than \$10,000 (\$5,000 for assets acquired with federal grant monies), must be charged to a non-personal expenditure subobject code.
 8. Sensitive items of any value, such as Firearms and pharmaceuticals, must be tracked by Departments.
 9. Stolen capital assets or walk-away items must be reported to the Police Department Support Bureau's Business Information Desk as soon as identified.
 10. The internal service department providing the service and / or the asset shall ensure the periodic inventory, preferably annually, of capital assets and walk-away items that are provided to a user department. The user department must report any missing items as soon as they are identified as missing in the manner prescribed by the providing internal service department.
 11. Each department's Property Control Officer(s) shall maintain a list of walk-away items and / or sensitive items being used by the department and periodically ensure that those items can be accounted for. The department must report any missing items at the time they are identified as missing.
 12. Privately owned property used by City employees on the job shall not be recorded in FAACS. Private property should be clearly marked as such.
 13. The Director of Financial Management is responsible for the initial development and, as needed, update of the procedures contained in Section VI of this regulation.
 14. City departments and offices are responsible to ensure the implementation and adherence to the above policies.

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VI. PROCEDURES

A) Performing a Physical Inventory

1. Department heads are responsible for taking physical inventory of their department's capital assets per the FAACS listing.
2. A physical inventory must be taken at least once a year. The results of the physical inventory must be reported to the Department of Financial Management, Accounting Bureau. This report must include all changes to the information kept in FAACS, including whether the asset is missing or stolen, and changes to information such as the estimated useful life of the asset or location and responsible persons.
3. The Department of Financial Management may require more frequent physical inventories.
4. Annually, before September 15th of each year, the custodian shall submit a Statement of Accountability accompanied by an inventory of City items under their control to the Department of Financial Management, Accounting Bureau. A Statement of Accountability is a signed document that attests to the condition of City assets under the custodian's control, how those assets are safeguarded from theft and damage, specifies when an inventory was conducted, and who conducted the inventory. Departments who oversee or contract with a custodian are responsible for the custodian's adherence to the applicable portions of this AR.
5. The Department of Financial Management is responsible for providing the FAACS listing to departments and communicating to the City Manager the results of the physical inventories.
6. The Department of Financial Management and/or City Auditor may elect to observe the departments' or custodians' physical inventories or take test counts of their assets to verify the accuracy of the inventories.
7. At a minimum, departments responsible for capital projects shall submit twice a year, by April 30th and October 30th, a Capital Improvement Project Status Listing for each active or recently completed capital project as of the end of the prior month to Department of Financial Managements, CIP Accounting division. The Capital Improvement Project Status Listing shall consist of the following information (if applicable):
 - o Project ID.
 - o Project type.
 - o Brief description of the project.
 - o Name, email address, and phone number of the Inspector / Project Manager.

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- o Actual cost to date.
- o Quantity.
- o Date placed into service.

B) Recording Capital Assets

1. All City property which meets the definition of capital asset, as outlined in Section V, must be recorded in the City's FAACS. Distinctive identification labels will be assigned by the Financial Management Department, Accounting Bureau. Each label will have a separate and unique number. The labels must be mounted in a conspicuous place, preferably on the outside upper right hand corner of the property.
2. Capital assets will be set up in FAACS at their full cost. Depreciation will begin on the date the asset is placed into service. The department that purchases an asset must submit an Asset Data Form (see Attachment A) to the Department of Financial Management, Capital Asset Section. All pertinent paperwork (invoices, project cost summary sheet, etc) substantiating the cost being capitalized should be attached.
3. Assets developed/constructed by proprietary funds (enterprise and internal service funds), financed by a debt instrument, such as a bond, or through existing non-grant related resources where debt is outstanding within the fund, shall include the cost of interest accrued during the acquisition of those assets as part of the cost of the assets.
 - Only in cases where tax exempt debt has been issued and the borrowings are externally restricted to the acquisition of specified qualifying assets, the accrued interest expense is to be netted against any interest income resulting from the investment of the debt proceeds that has been earned during the acquisition period.
 - Interest revenues are not to be netted against taxable debt.
 - As long as there is existing debt outstanding and existing resources are used to finance the acquisition of a capital asset within the same fund, the related interest expense is to be considered part of the cost of acquisition.
 - Interest capitalization begins at the start of preconstruction activities and ends when the asset is substantially ready to be placed into service.
 - The amount of interest to be capitalized is calculated by applying the weighted average rate of interest on outstanding debt of the fund to the average amount of accumulated expenditures for the asset during the period.
 - No capitalized interest is applied to the portion of an asset that is acquired through the use of grant funds.

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- Capitalization of Interest should be suspended during any voluntary cessation of the acquisition process (e.g. construction stoppage due to budget cuts)
- 4. Major computer and software purchases and development costs will be recorded, as one asset in FAACS, and the cost will be depreciated over the estimated useful life. Each department must establish a separate expenditure account (e.g., index code or project) in the City's Financial System to track the costs of developing major software systems. Only amounts paid to vendors are capitalized; City employee's salaries are not capitalized.
- 5. Donated assets that meet the definition of a capital asset must be recorded in FAACS. Donated assets must be accepted by the City Council. The value assigned to donated assets must be the fair market value of the asset on the date of donation.
- 6. Most assets acquired through a capital lease are considered capital assets and must be recorded in FAACS. To determine whether an asset acquired through a capital lease is considered a capital asset, one of the following criteria must be met:
 - The lease transfers ownership at the end of the lease term.
 - There is a bargain purchase option. A bargain purchase option is a provision that allows for the purchase of the asset at a price that is significantly lower than the expected fair market value of the asset at the option date. The option date is specified in the lease agreement and is generally at the end of the lease term (i.e. "Lessee has the option to purchase the asset for \$1.00 within ten days from the end of the lease term"). This determination is made at the inception of the lease and the difference between the option price and the property's expected value must be substantial enough that exercise of the option is reasonably assured. Both option price and expected value is as of the option date, which is usually at the end of the lease.
 - The lease term is at least 75% of the asset's useful life.
 - The present value of the minimum lease payments is at least 90% of the fair market value of the asset. If principal and interest is identified in the agreement, the present value of the lease payment is the principal portion at the lease inception.

Any lease that does not meet at least one of the above criteria will be considered an operating lease and will not require an Asset Data Form. The department purchasing the equipment will make the determination of whether a lease is a capital lease or operating lease with the assistance of Financial Management

The depreciation period for an asset purchased through a capital lease is based on the conditions of the lease. There are two methodologies that shall be used:

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- (a) If the lease either transfers ownership at the end of the lease term or the lease contains a bargain purchase price, then the asset is depreciated over the economic life of the asset,
- (b) Under all other circumstances, depreciation should be calculated over the term of the lease, down to guaranteed residual value, if any.

When many small items are purchased under a capital lease the assets are bundled and capitalized as a unit, usually for the same amount of the initial liability. Generally, if the majority of the individual items have been junked, salvaged or cannibalized and the asset has been fully depreciated, the asset should be retired from the system at the end of the lease term.

- 7. Land and buildings purchased for use in government operations should be capitalized in FAACS. Land and buildings acquired for the express purpose of resale are considered financial assets and are properly recorded as "Land held for resale". These financial assets are only recorded in FAMIS. The intended purpose at the time of the purchase determines whether the asset is considered a capital or financial asset. Intended purpose can be changed at a later date and requires proper notification to Financial Management, including the completion of capital asset acquisition and/or retirement form(s). Departments should review "Land held for resale" annually, in conjunction with the annual inventory to ensure financial treatment of land and buildings as either a capital or financial asset is consistent with City Council's current intent.
- 8. Capitalized land purchase costs should include all costs incurred in getting the land into a usable condition, including purchase price, site clearance costs, escrow costs, title search costs, and other third party costs relating to the purchase. The amounts should be identified separately on the Asset Data Form to ensure that the purchase price and miscellaneous costs are properly recorded.
- 9. Departments that purchase land must submit an Asset Data Form to the Department of Public Works, Property Services Bureau.
- 10. The Property Services Bureau will review the Asset Data Form for completeness, record the deed with the County Recorder and forward the approved form to the Department of Financial Management, Accounting Bureau.
- 11. Land must be recorded in FAACS using the deed number (or other appropriate number as determined by the Property Services Bureau) as the City asset number. The Assessor Parcel Number (APN) must be included in the tax map number field on the Asset Data Form; the land acreage listed in the model number field; and the intended use of the land listed in the notepad.
- 12. Departments responsible for capital projects must submit an Asset Data Form for each completed or in use project to Department of Financial Managements, CIP Accounting division.

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13. Departments shall set-up projects that are expected to be capitalized as project type "C" projects in FAMIS.
 - Established Projects in FAMIS shall not commingle capitalizable and non-capitalizable expenses within project details.
 - Any project type "C" amounts that are later determined to be expensed rather than capitalized (feasibility studies, etc.) shall be accounted for using the appropriate standardized project detail for this purpose (project detail "05", project type "O").
14. Small tools and equipment such as wrenches, hammers, drills, etc. that do not meet the capitalization minimum amount shall not be recorded in FAACS. Departments shall maintain a policy to control these items.
15. Records relating to items acquired with grant funds or trust monies shall be maintained based on the regulations set up in the respective grant contracts or trust documents. Copies of these contracts and documents must be available to the Financial Management Department, Accounting Bureau, to ensure compliance.

C) Transferring Capital Assets

1. Departments must immediately submit an Asset Transfer Form (See Attachment B), signed by both transferring and receiving department heads, to the Financial Management Department, Accounting Bureau, when property that is tracked by the Capital Asset System is transferred from one bureau or division to another, one department or to another department or one fund to another. Both original cost and accumulated depreciation is transferred to receiving department/fund whether or not a cash transfer is part of underlining transaction. The value of a capital asset cannot change solely as a result of being moved across departments/funds.
2. An Asset Retirement Form must accompany all assets transferred to Technology Services for disposal. (See Section VI. C)
3. Financial Management, Accounting Bureau, must record property transfers in FAACS unless otherwise delegated to the department.
4. Due to the Tidelands Trust agreement between the State of California and the City, only departments that work in the Tidelands Trust area may use Tidelands Trust property. All Tidelands Trust assets that have a positive remaining book value (i.e., original value less accumulated depreciation) and/or are marketable as determined by the Technology Services Department, Property Sales Division, must be sold through a bid process.

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D) Retiring Capital Assets

1. Capital assets are considered retired when sold, salvaged, traded-in, or found to be unserviceable.
2. Departments are responsible for coordinating the disposition of assets to be retired through Technology Services, Administrative Services Division. Assets designated for disposal must be itemized and labeled for disposal, in accordance with the Department of Technology Services directives, as well as submitting the completed signed forms once the assets have been picked up. Fleet vehicles are disposed of through Fleet Services.
3. Departments are not authorized to dispose of capital assets belonging to another department.
4. All assets may be transferred to other City departments, sold at auction, or disposed of in the best interest of the City.
5. City property that is determined by the department head or their designee to be excess property that is not in serviceable condition, has no salvage or sale value, has not been retired from or is listed in FAACS, and is not an item whose disposal is restricted by existing law, other sections of this regulation, any other ordinance or regulation, or common sense, may be disposed of directly without being sent to the Technology Services, Administrative Services Division. A listing of any property disposed of in this manner shall be prepared, signed by the department head or designee, and forwarded to the Technology Services, Administrative Services Division for record keeping.
6. Real property sales are handled and reviewed by the Property Services Bureau. The tax map number must be referenced for real property sales.
7. Unserviceable items that are in FAACS and are considered to be non-saleable, shall be retired from FAACS.
8. The Technology Services Property Agent or designee must review and approve all Capital Asset Retirement Forms, and forward the Capital Asset Retirement Form to the Financial Management Department, Accounting Bureau. Should the Technology Services Property Agent decide to transfer the asset to another City department, the Technology Services Property Agent will recode the department's retirement form to indicate the asset as having been transferred instead of retired.
9. The Technology Services Property Agent is not responsible for the retirement of fleet vehicles.
10. Financial Management must record retirements in the FAACS unless otherwise delegated to the department.

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11. When a sale is made of one or more of the rights to a parcel of land (an easement), the gain or the loss on the sale of land depends on the cost attributable to the interest sold. If the legal documents describe the percentage of rights sold, this percentage is used to calculate the gain/loss. The estimated fair market value immediately before and after the sale can also be used to determine percentage of original assets cost allocated to rights sold. Please note that only easements that are permanent in nature should be recorded as a reduction of the cost of land. Temporary, short-life easements, such as construction easements, should not affect the carrying or book value of the asset.

E) Retiring Items Less Than \$10,000

1. To retire items not in the FAACS that can be repaired for resale or sold through Property Sales, the department must list these items on a Property Auction Manifest Form (See Attachment C). The form must accompany the items sent to Technology Services, Administrative Services Division. The department head or designee must sign this form.

Departments can dispose at their discretion items that originally cost less than \$10,000 (\$5,000 for assets acquired with federal grant monies) and cannot be repaired and / or sold through Property Sales. Approval must be obtained from the department head or designee prior to disposal. Departments can contact the Technology Services, Administrative Services Division to determine if the items can be salvaged or to receive instructions on how to dispose of non-salvageable items.

F) Missing or Stolen Capital Assets

1. The department head or designee must immediately report to the Police Department, Support Bureau, Business Information Desk, City Auditor and Director of Financial Management the theft of any capital asset.
2. If a capital asset is missing, the department head must submit an Asset Retirement Form (Attachment B) and a Supplemental Capital Asset Report (Attachment C) to the Director of Financial Management, Accounting Bureau. If an asset is known to be stolen, a police report is required in addition to the Retirement Form and Supplemental Capital Asset Report. The Supplemental Capital Asset Report must include an explanation of when the property was discovered to be missing, how it was lost or stolen, whether similar losses or thefts have taken place, and what steps are being taken to avoid similar losses or thefts in the future. If applicable, Grant and Trust regulations regarding missing or stolen assets should be followed if asset was funded by either grant or trust monies.

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