Agricultural Accounting: A Case on Asset Valuation

Barbara Wheeling
University of Southern Colorado

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AGRICULTURAL ACCOUNTING:
A CASE ON ASSET VALUATION

BARBARA WHEELING
UNIVERSITY OF SOUTHERN COLORADO
HASAN SCHOOL OF BUSINESS

ABSTRACT

The purpose of this case is to create greater awareness for both students and educators of alternative accounting methods recommended for specific industries such as agriculture. Many issues in traditional accounting courses are not relevant for agricultural businesses. This case provides students with an experience in explaining the nature of and accounting for market valuation of assets as recommended in the Financial Guidelines for Agricultural Producers which can be applied to real-world farm clients.

I. BENSON FARMS

Located in central North Dakota, Benson Farms is situated in the heart of fertile and diversified farmland. The farm is owned by Richard Benson (“Rich”) who inherited the farm headquarters consisting of 1500 acres of land and farm buildings and other improvements. Additional land was purchased to expand the cattle herd and consists mainly of pastureland. The farm produces grain (mostly wheat and barley), hay, and feeder cattle. The cowherd consists of 145 head of crossbred beef cows. The farm business is organized as a sole proprietorship.

During the 1990's Rich has been monitoring the events concerning the development of accounting guidelines for farm and ranch operations. In 1989 a group called the Farm Financial Standards Council (FFSC) was formed with the mission of developing and promoting uniformity and integrity in financial reporting and analysis for the benefit of agricultural producers, lenders, and other interested parties. In 1997 the FFSC issued “Financial Guidelines for Agricultural Producers” (FGAP), a set of recommendations for the preparation and analysis of farm financial statements. FGAP describes in detail the accounting methods and calculations that differ from Generally Accepted Accounting Principles (GAAP) as well as pointing out where the FGAP recommendations are similar to the methods prescribed in GAAP.
Rich has decided that he needs to begin using FGAP as the basis for producing his own farm financial statements. Although quite educated in the agricultural field, he has a limited understanding of accounting. He has hired Beasley Business Services, a small local CPA firm, to assist him in understanding these new guidelines. Nate Beasley, the owner of Beasley Business Services, has little knowledge concerning these guidelines himself. Therefore, he has asked members of his staff to assist him in understanding the differences between GAAP and FGAP. As one of the staff members, you are part of the team that has been assigned to work on this project.

II. FINANCIAL GUIDELINES FOR AGRICULTURAL PRODUCERS

Your team located the website for the FFSC (http://www.ffsc.org) and, after studying the guidelines, wrote an executive summary on the differences between GAAP and FGAP. The team determined that there were seven major areas of difference. A summary of their report contains the following information.

Issue #1: Market valuation of assets. GAAP requires that book values (cost less accumulated depreciation) be reported on the balance sheet for most assets. FGAP recommends that market values for most assets be shown on the face of the balance sheet. Book values alone are acceptable but for analytical purposes the FFSC recommends that both book values and market values be presented.

Issue #2: Valuation of Raised Breeding Livestock. GAAP requires full cost absorption for assets such as raised breeding livestock. FGAP recognizes full cost absorption as an acceptable method for valuation of raised breeding livestock but also allows the base value approach.

Issue #3: Valuation of inventory (other than raised breeding livestock). These inventory items include livestock raised or purchased for sale, crops purchased for use or sale, and crops raised for use or sale. The lower-of-cost-or-market rule (LCM) required for inventory according to GAAP is recommended in FGAP for crops purchased for use. LCM is the preferred method for crops purchased for sale, crops raised for use, and livestock purchased for sale but an alternative method is also allowed for these categories. Crops raised for sale and livestock raised for sale should be valued according to net realizable value according to FGAP.

Issue #4: Combined Financial Statements. In certain circumstances, FGAP recognizes the need to combine farm business assets, liabilities, and equity with personal assets, liabilities, and equity. In those situations, accounts are maintained and financial statements are prepared with personal items included.
Issue #5: Accrual-adjusted Income Statements. GAAP requires accrual accounting for all accounts. FGAP recommends a modified cash-basis system which utilizes cash-basis accounting and certain accrual adjustments at year-end so that accrual-adjusted net income is reported in the income statement.

Issue #6: Deferred Taxes. FGAP recommends an alternate calculation for deferred taxes from that required by GAAP. Market value adjustments and the accrual adjustments alluded to in Issue #6 must be taken into account in these calculations. In sole proprietorships and partnerships income tax expense is a personal expense and may or may not be shown on the farm financial statements, depending on whether personal items are included in the financial statements.

Issue #7: Income statement format. FGAP recognizes two formats for the income statement. The Gross Revenue format resembles formats used in practice by non-agricultural business. The VFP (Value of Farm Product) format contains a section similar to but not exactly the same as the Cost of Goods Sold section found on some income statements.

Mr. Beasley has assigned each of the issues to one staff member to gather more detailed information on the issues and to make recommendations for Benson Farms.

1. ISSUE #1: MARKET VALUATION OF ASSETS

Your assignment is the issue on market valuation of assets and the format of the balance sheet. In order to complete your assignment, you will use the farm chart of accounts shown in Exhibit 1 and will refer to the FFSC website. The following information concerning Benson Farms will be necessary to make recommendations to Mr. Beasley.

EXHIBIT 1

Farm Chart of Accounts

- 1000 Cash
- 1100 Accounts Receivable
- 1210 Feeder Livestock Inventory
- 1220 Feed Inventory
- 1230 Crop Inventory
- 1300 Prepaid Expenses
- 1400 Cash Investment in Growing Crops
- 1500 Breeding Livestock
1510 Breeding Livestock Inventory
1600 Machinery and Equipment
1650 Office Furniture and Equipment
1700 Perennial Crops and Natural Resources
1800 Land, Buildings and Improvements
1900 Investments in Cooperatives and other Investments
1910 Leased Assets
1950 Personal Assets
2000 Accounts Payable
2100 Taxes Payable
2200 Interest Payable
2300 Notes Payable--non-current
2310 Notes Payable due within one year
2400 Real Estate Notes Payable--non-current
2410 Real Estate Notes Payable due within one year
2500 Deferred Taxes--non-current
2510 Deferred Taxes--current
2600 Obligations on Leased Assets
2610 Obligations on Leased Assets due within one year
2700 Personal Liabilities
3000 Valuation Equity
3010 Change in Excess of Market Value over Cost
3020 Change in Non-current portion of Deferred Taxes
3100 Retained Capital
3110 Owner Withdrawals
3120 Non-farm income
3130 Gifts and Inheritances
3210 Change in Value of Personal Assets
3220 Change in Personal Liabilities
3230 Personal Equity
4000 Cash Crop Sales
4010 Changes in Crop Inventories
4100 Cash Sales of Market Livestock and Poultry
4110 Changes in Market Livestock and Poultry Inventories
4200 Livestock Products Sales
4300 Proceeds from Government Programs
4400 Crop Insurance Proceeds
4500 Gains/Losses from Sale of Culled Breeding Livestock
4600 Change in Value due to Change in Quantity of Raised Breeding Livestock
4700 Change in Accounts Receivable
4800 Miscellaneous Revenue
5000 Feeder Livestock

5010 Change in Purchased Feeder Livestock Inventories
5020 Purchased Feed
5030 Change in Purchased Feed Inventories
5100 Wages Expense
5110 Payroll Tax Expense
5120 Board for Hired Labor
5130 Insurance for Hired Labor
5200 Repairs and Maintenance for Farm Vehicles, Machinery, Equipment
5210 Small Tools and Supplies
5220 Repairs and Maintenance for Buildings and Improvements
5300 Rent
5310 Truck and Machinery Hire
5400 Fuel, Oil, Gas, Grease
5500 Seed
5510 Fertilizers
5520 Herbicides, Pesticides
5530 Twine, Sacks
5540 Poisons, Seed Tests
5600 Veterinarian, Vaccinations, Medications
5610 Breeding fees, Registrations
5620 Disinfectants, Sprays
5630 Livestock Supplies, Tools, and Equipment
5640 Shearing
5641 Wool Twine and Sacks
5650 Livestock Inspections
5700 Insurance
5710 Real Estate and Personal Property Taxes
5720 Electricity
5730 Water
5740 Telephone
5750 Office Supplies
5760 Dues, Journals and Papers
5770 Bank Charges
5780 Depreciation Expense
5800 Interest Expense
5810 Change in Interest Payable
5820 Change in Accounts Payable
5830 Change in Prepaid Insurance
5840 Change in Investment in Growing Crops
The 1500 acres that was inherited by Rich had a value of $800 per acre at the time of the inheritance and consists mostly of cropland. Similar land in the area recently sold for $900 per acre. The pastureland consists of 300 acres purchased recently for $250 per acre. Prices for pastureland have not changed much since the purchase. Buildings and improvements after accumulated depreciation of $55,000 have a book value of $55,000. An appraisal indicates that book value is relatively close to market value for the buildings and improvements. Machinery and equipment had a total cost of $175,000 and now have a book value of $90,000. Total market value for machinery and equipment is approximately $100,000. 145 breeding cows have a base value of $500 per head and a market value of $400 per head. (Note that base values are used so depreciation is not recorded. Therefore, book value and base value mean the same thing in this case.) The five bulls had a total purchase price of $7500 with accumulated depreciation of $5500 and a market value of $3000.

During the year Rich purchased $1500 worth of feeder pigs, sold half when prices rose, and still has half on hand with a market value of $900. The value of the feeder calves at weaning time was $40,000 and is now $35,000. Rich raised and harvested hay with a value of $3500, sold $500 worth, used up $1200 worth, and now the remainder has a market value of $2000. Rich also raised and harvested grain with a value of $18,000 at harvest time. He sold two-thirds of it and the remainder has a market value of $5400. He also purchased feed for $1000, of which $770 has been used and the remainder has a market value of $400.

2. QUESTIONS:

Your assignment is to answer the following questions.

1. What are the alternative formats for balance sheet presentation recommended by FGAP?

2. Discuss the advantages and disadvantages of presenting market values for assets on the balance sheet. In your answer, discuss why GAAP requires the use of historical cost for the valuation of assets and FGAP recommends market valuation.
3. How would you account for the changes in the values of the inventory accounts (feeder livestock, feed (hay), and crop inventories)? How would you account for the changes in the values of the long-term assets described in the case? Prepare journal entries to support your answer and assume that Rich has elected to use the VFP format.

4. How is the account “Change in Excess of Market Value over Cost” classified (asset, liability, equity, revenue, or expense) and why is it classified as such? How are the accounts “Change in Crop Inventories”, “Change in Market Livestock and Poultry Inventories”, “Change in Purchased Feeder Livestock Inventories”, and “Change in Purchased Feed Inventories” classified (asset, liability, equity, revenue, or expense) and why are they classified as such?

5. Prepare the section of the balance sheet containing the inventory and long-term asset accounts using one of the formats recommended by FGAP. Do not use the GAAP format.

III. TEACHING NOTES

1. CASE SUMMARY

This case involves a fictional diversified farm business, called Benson Farms, located in central North Dakota. The farm’s main sources of income are sales from grain and feeder cattle. The farm business is organized as a sole proprietorship and is owned by Richard Benson.

The case begins with a brief description of the farm business and the motivation for understanding the Financial Guidelines for Agricultural Producers (FGAP) issued by the Farm Financial Standards Council (FFSC) in 1997. The next section outlines the differences between GAAP and FGAP. The next section focuses on the issue of market valuation of assets as recommended by FGAP and provides additional information concerning Benson Farms and the students’ assignment concerning this topic. A list of questions to be answered by the students follows.

2. BACKGROUND AND CASE OBJECTIVES

Although this case is based on a fictional farm business, the situation is familiar to the author who has a background in agriculture, a degree in Animal Science, and work experience on a ranch in North Dakota.
The objectives of the case are (1) to help students become aware of FGAP which is applicable to clients involved in agricultural enterprises, (2) to help students gain an awareness of the main differences between GAAP and FGAP, (3) to provide students with an understanding of market valuation of assets and provide them with experience in explaining the nature of market valuation and the concepts involved in financial reporting where market valuation is utilized.

The purpose of this case is to create greater awareness for both students and educators of alternative accounting methods recommended for specific industries, such as agriculture. The development of FGAP is relatively recent occurrence and few accounting textbooks, if any, address the differences between FGAP and GAAP. While traditional accounting courses have some relevance for agricultural students and educators, many issues are not relevant for agricultural businesses. Accounting in agriculture need to be updated, revised, and become more consistent among farm businesses for analytical and lending purposes. Agricultural and/or business curriculums need to be revised to teach accounting that is relevant for agricultural businesses.

3. CLASSROOM USE AND TEACHING METHODOLOGY

The knowledge gained in this case can be applied to real-world farm clients. Some of the other accounting issues in FGAP are relevant for non-farm businesses as well, such as the modified cash-basis system of accounting for small businesses. In addition, market valuation is relevant for international accounting. The International Accounting Standards Board recently issued a standard in which market valuation is recommended for agricultural businesses internationally. Furthermore, some countries, such as Australia, permit upward revaluation of assets in non-farm businesses.

This case can be used at the undergraduate level in an accounting theory course and perhaps in an intermediate or advanced accounting course. The first semester of intermediate accounting would be required prior to working on this case.

Students can work individually or in teams. The students are required to use the Internet to answer the questions. These questions can stimulate additional class discussion concerning the differences between GAAP and FGAP. The agricultural environment and characteristics of a farm business that give rise to these differences should be emphasized in the discussion.
4. CASE QUESTIONS

1. According to FGAP, market values and cost information (cost less accumulated depreciation) can be shown on the balance sheet for all assets except for accounts receivable, prepaid items, and investments in capital leases, cooperatives, or other entities. The presentation of market value information should be shown on the face of the balance sheet. Alternative formats for the balance sheet include 1) showing market values on the face of the balance sheet with cost and accumulated depreciation information shown in parenthetical references, footnotes, or supporting schedules or 2) presenting a double-column balance sheet with market values in one column and cost less accumulated depreciation information in the other column. (FGAP, p. II-12)

2. Advantages of using market values in the valuation of capital assets for a farm business include ease of calculation, a true representation of the farm’s assets, and a better evaluation of the financial position and financial performance of the farm business. Historical cost of some assets is often not known because of the length of time that has passed since the acquisition of the assets and the lack of records concerning the acquisition. For some assets, such as raised breeding livestock, cost information is difficult to calculate because costs of production are simply expensed and are difficult to trace to individual asset categories. Disadvantages of the use of market values include difficulty in estimating the values of certain assets, fluctuations in equity due to fluctuations in market values, and adjustments to equity that are quite possibly temporary. For some inventory items (such as crops and market livestock) a daily market price is easily determined from the market. However, for some items, such as land, buildings, and improvements, a readily available market price does not necessarily exist and true value may only be determined upon the sale of such assets. Market valuation is not consistent with the “going concern” principle of GAAP in that it results in reporting liquidation values on the balance sheet (FGAP, p. II-16). GAAP requires the presentation of historical cost information less accumulated depreciation with market values only as supplementary information due to the ability to verify cost numbers, the going concern principle mentioned above, and the concern over inflated market values which historically created problems for users of financial statements. The FFSC believes that a proper analysis of the borrowing capacity of a farm business requires both cost and market values (FGAP, p. II-12). This perspective probably reflects the situation during the 1980's when farmland values declined considerably and borrowing capacity based on cost information was no longer relevant or realistic.

3. Changes in values of feeder livestock are recorded in one of two accounts. Changes in value for livestock raised for sale are recorded in Changes in Market Livestock and Poultry Inventories (account #4110 from the chart of accounts)
and for livestock purchased for sale these changes are recorded in Change in Purchased Feeder Livestock Inventories (account #5010) if the VFP (Value of Farm Product) format for the income statement is used. The VFP format distinguishes between purchased and raised feeder livestock in calculating changes in market value. If the Gross Revenue format is used, only the 4110 account is used. (FGAP, p. II-18 to II-20).

Using the VFP format, the following journal entries apply to Benson Farms for changes in value of feeder livestock:

1210 Dr. Feeder Livestock Inventory 150
5010 Cr. Change in Purchased in Feeder Livestock Inventories 150
To record increase in value of purchased feeder pigs on hand. $900 - ($1500 - 750).

4110 Dr. Changes in Market Livestock and Poultry Inventories 5,000
1210 Cr. Feeder Livestock Inventory 5,000
To record decrease in value of raised feeder cattle. $40,000 - 35,000.

Changes in value for crops raised for use and crops raised or purchased for sale are recorded in Changes in Crop Inventory (account #4010) and for crops (or feed) purchased for use, market value changes are recorded in Change in Purchased Feed Inventory (account #5030) if the VFP format is used for the income statement. The VFP version distinguishes between crops raised for use and crops purchased for use in presenting market value changes. If the Gross Revenue version is used, only the 4010 account is used for market value changes.

The following journal entries pertain to Benson Farms for changes in market values of crops using the VFP format:

1220 Dr. Feed Inventory 200
4010 Cr. Changes in Crop Inventories 200
To record increase in value of hay raised for use. $2000 - ($3500 - 500 - 1200).

4010 Dr. Changes in Crop Inventories 600
1230 Cr. Crop Inventory 600
To record decrease in value of grain raised for sale. ($18,000 - 12,000) - 5400.

1220 Dr. Feed Inventory 70
5030 Cr. Change in Purchased Feed Inventory 70
To record increase in value of purchased feed for use. $400 - ($1000 - 770).
Changes in the value of other capital assets are recorded in an account called Change in Excess of Market Value over Cost (account #3010). The journal entries for Benson Farms would be recorded as follows:

1800 Dr. Land, Buildings and Improvements 150,000
3010 Cr. Change in Excess of Market Value over Cost 150,000

*To adjust value of land to market value. 1500 ($900 - 800).*

1600 Dr. Machinery and Equipment 10,000
3010 Cr. Change in Excess of Market Value over Cost 10,000

*To adjust value of machinery and equipment to market value. $100,000 - 90,000.*

1500 Dr. Breeding Livestock 1000
3010 Cr. Change in Excess of Market Value over Cost 1000

*To adjust value of breeding bulls to market value. $3000 - ($7500 - 5500).*

3010 Dr. Change in Excess of Market Value over Cost 14,500
1500 Cr. Breeding Livestock 14,500

*To adjust value of breeding cows to market value. 145 ($500 - 400)*

4. Change in Excess of Market Value over Cost is classified as an equity account. This account is a component of Valuation Equity in the owner equity section of the balance sheet (FGAP, p. II-12) and is not used in the calculation of net farm income (FGAP, p. II-36). An explanation for this treatment would involve distinguishing these value changes from normal production activities of the farm business because these changes involve assets that are used in production but are not assets available for sale, such as inventory.

Adjustments for raised inventory items are included in the revenue section of the income statement regardless of whether the VFP or Gross Revenue version is presented. Thus, the accounts, Changes in Market Livestock and Poultry Inventories and Changes in Crop Inventories, are considered revenue accounts. When using the VFP version, Change in Purchased Feed Inventories and Change in Purchased Feeder Livestock Inventories are related to inputs in the production process and are therefore classified as expense accounts. (FGAP, p. II-35).
5.

**BENSON FARMS**

Balance Sheet *(double-column format)*

<table>
<thead>
<tr>
<th></th>
<th>Market Value</th>
<th>Book Value</th>
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</thead>
<tbody>
<tr>
<td>Feeder Livestock Inventory</td>
<td>$ 900</td>
<td>$ 750</td>
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<tr>
<td>Feed Inventory</td>
<td>2,400</td>
<td>2,130</td>
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<td>Crop Inventory</td>
<td>5,400</td>
<td>6,000</td>
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<tr>
<td>Breeding Livestock</td>
<td>77,000</td>
<td>63,000</td>
</tr>
<tr>
<td>Machinery and Equipment</td>
<td>100,000</td>
<td>90,000</td>
</tr>
<tr>
<td>Land, Buildings, and Improvements</td>
<td>1,405,000</td>
<td>1,255,000</td>
</tr>
</tbody>
</table>

**BENSON FARMS**

Balance Sheet *(parenthetical format)*

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<thead>
<tr>
<th></th>
<th>Market Value</th>
</tr>
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<tr>
<td>Feeder Livestock Inventory (at cost $750)</td>
<td>$ 900</td>
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<tr>
<td>Feed Inventory (at cost $2,130)</td>
<td>2,400</td>
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<tr>
<td>Crop Inventory (at cost $6,000)</td>
<td>5,400</td>
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<tr>
<td>Breeding Livestock (at cost $63,000)</td>
<td>77,000</td>
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<tr>
<td>Machinery and Equipment (at cost $90,000)</td>
<td>100,000</td>
</tr>
<tr>
<td>Land, Buildings, and Improvements (at cost $1,255,000)</td>
<td>1,405,000</td>
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BENSON FARMS
Balance Sheet (footnote format)

Assets:

<table>
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<tr>
<th>Asset</th>
<th>Market Value</th>
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<tbody>
<tr>
<td>Feeder Livestock Inventory</td>
<td>$ 900</td>
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<tr>
<td>Feed Inventory</td>
<td>2,400</td>
</tr>
<tr>
<td>Crop Inventory</td>
<td>5,400</td>
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<tr>
<td>Breeding Livestock</td>
<td>77,000</td>
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<tr>
<td>Machinery and Equipment</td>
<td>100,000</td>
</tr>
<tr>
<td>Land, Buildings, and Improvements</td>
<td>1,405,000</td>
</tr>
</tbody>
</table>

Note: Feeder Livestock Inventory at cost, $750; Feed Inventory at cost, $2,130; Crop Inventory at cost, $6,000; Breeding Livestock at cost, $63,000; Machinery and Equipment at cost, $90,000; Land, Buildings, and Improvements at cost, $1,255,000.

BENSON FARMS
Balance Sheet (with supporting schedules)

Assets:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feeder Livestock Inventory</td>
<td>$ 900</td>
</tr>
<tr>
<td>Feed Inventory</td>
<td>2,400</td>
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Inventory Valuation

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<tr>
<td>Crop Inventory</td>
<td>5,400</td>
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### Market Value vs. Book Value

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<tr>
<td>Bulls</td>
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<td>2,000</td>
<td></td>
</tr>
<tr>
<td>1,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cows</td>
<td>60,000</td>
<td>75,000</td>
<td>(15,000)</td>
</tr>
<tr>
<td>(15,000)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>63,000</td>
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#### Machinery and Equipment

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<th>Book Value</th>
<th>Difference</th>
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</thead>
<tbody>
<tr>
<td>Machinery and</td>
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<td>90,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Equipment</td>
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#### Land, Buildings, and Improvement

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<th>Book Value</th>
<th>Difference</th>
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</thead>
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<td>1,200,000</td>
<td></td>
</tr>
<tr>
<td>150,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and</td>
<td>55,000</td>
<td>55,000</td>
<td></td>
</tr>
<tr>
<td>Improvements</td>
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</tr>
<tr>
<td>Total</td>
<td>1,405,000</td>
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</table>

* Book Value equals cost less accumulated depreciation.

### REFERENCES