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Cohn: Lower of cost or market principle in the Talmud
**THE LOWER OF COST OR MARKET PRINCIPLE
IN THE TALMUD**

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This paper gives a historical perspective on the lower of cost or market (LCM) pricing system. It shows that a similar system is used in Talmudic literature. The Talmud is the compilation of Jewish oral law. It explains the meanings behind the Torah's verses. The Talmud consists of the Mishna and Gemara. The Mishna was compiled and edited approximately 1,800 years ago. The Gemara was written a few hundred years later. It focuses on presenting commentaries on the Mishna.

Accountants can have flexibility regarding what price to use for valuing an asset. The decision regarding which price to choose is based on two factors. First, the price should have a source of legitimacy. Second, the price should maximize a social objective. LCM is an example where accountants have flexibility regarding which value to use. Accountants use LCM to value inventory. Inventory is usually valued at historical cost. However, a departure from the historical cost principle is made when inventory's value drops below its original cost. Under this circumstance the inventory must be written down to reflect the new value. The social objective for using LCM is the conservative principle. Furthermore, the two possible values for inventory, cost and market, are both legitimate measures.

The LCM pricing mechanism appears in several places in the Talmud. In all cases where LCM is used, its choice is made based on the criterion of maximizing a social value and choosing between legitimate measures. Four examples from the Talmud are the following:

First, in Tractate Manochos (90a), it is discussed how one should price merchandise which is sold to the Temple. The Temple is

the sanctuary where in ancient days many of the Jewish rituals were performed. According to Talmudic principles, goods are normally priced depending upon their value at the time of delivery. Thus, if the price goes down between purchase and delivery, the buyer gains. Similarly, if the price increases, the buyer loses. However, with regards to the Temple, a different pricing system is used. Technically goods which are bought by the temple are supposed to be priced according to the value at time of purchase. However, the Rabbis did not want the Temple to ever be inferior to the layman. Therefore, if there was a price decrease at the time of delivery, the Rabbis allowed the Temple to purchase the goods at the lower price. Alternatively, if the price increased, the Temple was given the option of remaining with the lower original price.

Thus, in terms of pricing for the Temple, a LCM system is used. The Temple pays whatever is less, the price at the time of sale or the market price at delivery. Either price is legitimate. Based on maximizing a social value, if the price drops, the lower one is chosen. The social value is that the Temple should not have to pay more for goods than a layman in a similar situation. However, the Temple should still be allowed to remain with its privilege to pay the original price from time of purchase.

Second, in Tractate Kiddushin (20a) it is discussed how a person that was sold into slavery redeems himself. In order for a person to be redeemed, three pieces of information are needed - how long was he sold, how many years he has worked and what is his value. For example, if he was sold for five years, he has worked for two years and his value is five dollars, he is considered to have been sold for

one dollar per year. Since he has three years left, the owner has an asset of three dollars. As a result, the slave can be redeemed for three dollars.

Complications in the above calculations occur if the selling price of slaves has changed from the time of purchase to the time of redemption. The Torah has a social objective to facilitate the redemption of slaves. It allows the slave to redeem himself based on the lower of either purchase price or present value. If the price of slaves goes to two dollars per year, the Torah allows the slave to redeem himself for one dollar per year. However, if the price decreases to fifty cents per year, the slave is allowed to redeem himself at this lower price. For example, if there are three years left, he can redeem himself for \$1.50. Redemption of the slave provides another illustration of how the Talmud uses the LCM rule. The lower price is chosen based on the social objective of facilitating the slaves redemption. Both prices which are considered, the original selling and current market, are legitimate pricing mechanisms.

Three, the Mishna in Tractate Baba Kamma (9:4) discusses the situation of a craftsman who by mistake dyes his customer's fabric the wrong color. According to the final opinion in the Mishna, the craftsman gets paid the lower of either his out of pocket costs or the amount of money which his efforts increased the value of the material. Since it is considered that the craftsman made a mistake, he is not allowed to charge his normal price for dyeing the object.

Again from this example, the Talmud uses LCM to accomplish social objectives. If a craftsman erroneously performs the wrong operation, it is not considered correct that he should be able to collect his full price. The customer gained something from the craftsman's work, and it is appropriate that the craftsman should receive payment. The Mishna gives the craftsman the lower between two legitimate prices-his out of pocket costs or the value by which he improved the material.

Finally, in the Tractate Baba Mitziah (101a), a situation is discussed concerning a gardener planting a tree in a landowner's field without being hired to perform this task. The Talmud says that the gardener should be paid the lesser of either his out of pocket costs or the amount that this tree has improved the land's value. In this case the Talmud also uses LCM to promote a social objective. The gardener should not be allowed to charge his normal landscaping fee since he was not requested to do the planting. However, the land's price has increased due to the gardener's efforts. Therefore, the gardener deserves to be paid something. The choice is made between two legitimate prices- the improvement in the value of the field or the gardener's costs.

In summary, the above examples illustrate that the accounting LCM principle dates to the Talmudic laws. As in the case of the accounting principle, the Talmud uses two legitimate prices and chooses the lower one based on promoting a social objective.

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