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THE LOWER OF COST OR MARKET PRINCIPLE IN THE TALMUD

by

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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.

WANTED MANUSCRIPTS AND ITEMS OF INTEREST

Anyone wishing to submit short article manuscripts, notes, cartoons, shaggy dog stories, letters to the editor, or other items to THE ACCOUNTING HISTORIANS NOTEBOOK should send the material for consideration to the editor, Kumar N. Sivakumar, School of Accountancy, Georgia State University, P.O. Box 4050, Atlanta, GA 30302.

THE ACADEMY OF ACCOUNTING HISTORIANS

Meeting of Trustees, Officers and Key Members

Adam's Mark Winston Plaza Hotel

Winston-Salem, North Carolina

Saturday, April 18, 1998

Present: Ashton Bishop, Edward Coffman, Richard Fleishman, Sarah Holmes, Thomas Lee, Paul Miranti, Gary Previts, William Samson, Elliott Slocum and Rasoul Tondkar.

1. The meeting was called to order at 1:00 p.m. by President Elliott Slocum
2. The minutes of the December 1997 Trustees, Officers and Key Members were distributed by Secretary Bill Samson. These minutes were approved.
3. The April 1998 membership report was distributed and discussed. It was noted that membership was currently ahead of last year's numbers.
4. The 1997 financial reports and the 1998 budget were distributed by Sarah Holmes. The refund of the Academy's contribution to the World Congress at Queen's University was discussed. Thanks was expressed for the return of this seed money.
5. It was proposed that the Public Relations Committee study ways to get CPA firms which contribute support to the Academy recognized in Academy publications and that work be done to publish firm histories. Also the Public Relations Committee is charged with devising a way to ensure Academy publications are distributed to contributors.
6. Dick Fleishman gave the editor's report for *AHJ*. The June 1998 issue is in the blueline stage and will be mailed out before June 1. Elliott Slocum, editor of the *Notebook*, stated that the April issue is now in galley form and will be mailed by the end of May. Placing the *Notebook* on the Academy's website was discussed.
7. Ed Coffman nominated Merv Wingfield for life membership. It was decided that the Trustees would vote by mail.
8. Ross Tondkar discussed the need to nominate an Academy member for the office of secretary.
9. Bill Samson submitted a resolution authorizing him to negotiate with The University of Alabama to reimburse the University for the services of Mrs. Kathy Rice as Academy Administrator. After word changes were made to the resolution, the resolution was voted and approved. An amendment was made to the budget for funding the administrative position. This increase was voted and passed.
10. Elliott Slocum gave the progress report about the research conference in November. The call for papers has been mailed to members and hotel arrangements are being finalized.
11. The Research Center reports were given. Ole Miss has received the McMickle collection and may also receive the Equity Funding papers for its EDP archives. The Georgia State research counter work is continuing. Tom Lee discussed the possibility of housing a collection at The University of Alabama which focuses on the professionalization of accounting. There was discussion of having Spring meetings at the research centers. This will be discussed at the New Orleans meeting. The general issue of shifting historical collections between the centers was discussed.
12. The 8th World Congress of Accounting Historians will meet July 19-21, 2000, in Madrid, Spain. It was proposed and passed that up to \$500 for promotional material for the 8th World Congress meeting be added to the budget.
13. At the upcoming New Orleans meeting,

- the Comparative Research in Accounting History Committee will issue a report and request funding in the budget.
14. Committee reports were distributed. These included the Financial Advisory Committee (Mayer), the Membership Committee which is focusing on a long-term program (Beard), and the Regional Program and Continuing Education Committee (Harris).
 15. The Trustees, Officers and Key Members will meet Sunday afternoon, August 16th in New Orleans.
 16. Jeanette Sanfilippo's Public Relations Committee report was given, followed by the International Relations Committee's report (Vangermeersch).
 17. Ashton Bishop stated that the Strategic Action Committee had nothing to report at this time. He gave Donna Street's report about the Vangermeersch Award being publicized. It was moved, voted and approved that the Vangermeersch award be increased from \$500 to \$1,000 effective 1998.
 18. Paul Miranti gave the Research Committee's report. Progress is being made on the research project.
 19. The meeting adjourned at 4:45 p.m.



THE ACADEMY OF ACCOUNTING HISTORIANS

Meeting of Trustees, Officers and Key Members

New Orleans Hilton Riverside Hotel

Sunday, August 16, 1998

Present: Victoria Beard, Ashton Bishop, Edward Coffman, Richard Fleischman, Dale Flesher, Finley Graves, Sarah Holmes, Tom Lee, Alan Mayer, Barbara Merino, Lee Parker, Gary Previts, John Rigsby, William Samson, Jeanette Sanfilippo, Kathy Sinning, Elliott Slocum and Donna Street.

1. President Elliott Slocum called the meeting to order at 1:00 p.m.
2. The minutes of the April 18th meeting (Winston-Salem) of Trustees, Officers and Key Members were approved.
3. The membership report was given by the Secretary.
4. Victoria Beard announced that the Membership Committee would be undertaking a satisfaction survey of the Academy membership.
5. Secretary Samson reported that Ms. Kathy Rice would become the Academy's Administrative Coordinator as soon as the paperwork is completed in the arrangement with The University of Alabama.
6. Sarah Holmes gave the Treasurer's report.
7. Richard Fleischman reported that the December 1998 issue of *The Accounting Historians Journal* was on schedule and distributed copies of the table of contents. Also distributed was the submission report which was discussed.
8. Elliott Slocum stated that September 1 was the deadline for materials to be included in the Fall edition of the *Notebook*. Types of material that might be submitted were discussed.
9. Jeanette Sanfilippo displayed the promotional materials that the Public Relations Committee had designed. The new t-shirt with the bookkeeping student was being featured. Also, pens for the World Congress in 2000 were available at the Academy's booth in the Exhibit Hall. Notecards and silent book auction (for the November Conference)

ees, officers and key members; New Orleans Hilton Riverside Hotel, Sunday, August 16, 1998; Meeting of Action Committee would be presented were in progress. Jeanette reported her contact with the St. Louis World's Fair planners and their willingness to host the World Congress in 2004.

10. Finley Graves reported his hope that the Monograph Series might be revived under an arrangement with Dartmouth Press. He also proposed that a co-editor for the Monograph Series be appointed. The motion was made, seconded, voted and approved to establish a co-editor for the monographs.
 11. Donna Street reported that the 1998 Vangermeersch Award winner is Michael P. Schoderbek.
 12. Dale Flesher described the move of the Tax History Research Center to the new building at Ole Miss.
 13. Elliott Slocum announced that the Accounting History Research Center's collection at Georgia State had been catalogued and currently the holdings were being rearranged.
 14. Elliott Slocum reported that the 1998 Fall Conference would be held at the Westin Peachtree Hotel in Atlanta on November 12-14. The submitted papers were in the process of being reviewed for the conference.
 15. Ed Coffman nominated Merv Wingfield for Life Membership. The proposal was seconded, voted and approved.
 16. The 1999 Academy Conference was discussed and the contributions and efforts of Gary Spraakman, Alan Richardson and others cited. To commence the planning process, a motion was made, seconded, voted and approved that the 1999 Conference be held in Toronto, November 18-20, 1999.
 17. Reports of committees were given. The Nominations Committee 1999 slate of trustees and officers was distributed (copy attached). Lee Parker gave the International Relations Committee's report. Elliott Slocum gave Paul Miranti's Research Committee's report. Ashton Bishop said that his Strategic
18. Tom Lee released his proposal for the formation of the Comparative International Accounting History Consortium. After considerable discussion, it was proposed that the consortium, contingent on outside funding, would meet May 20-22, 1999 in Tuscaloosa, Alabama. The consortium would include the editor of AHJ and would be piggybacked on the Spring meeting of Trustees, Officers and Key Members. The proposal was seconded, voted on and approved.
 19. It was proposed that three sessions for Academy papers prior to the AAA meeting in San Diego in August 1999 be arranged and organized. This motion was seconded, voted on and approved.
 20. The meeting adjourned at 4:10 p.m.

REPORT OF THE NOMINATING
COMMITTEE
NOMINATIONS OF OFFICERS AND
TRUSTEES FOR 1999

Officers

1. President, Tom A. Lee,
The University of Alabama
2. President-Elect, Kathleen E. Sinning,
Western Michigan University
3. First Vice-President, O. Finley Graves,
Kansas State University
4. Second Vice-President, William D.
Samson, The University of Alabama
5. Treasurer, Sarah A. Holmes,
Texas A & M University
6. Secretary, Alan J. Richardson,
Queens University (Canada)

Trustees

1. Gene Flegm (Chairman Emeritus)
2. Daniel L. Jensen, Ohio State University
3. Hiroshi Okano, Osaka City University
4. Dale Flesher, University of Mississippi
(Chairman of the Board of Trustees)
5. Elliott Slocum, Georgia State University