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BIBLICAL BASIS OF FORTY-YEAR GOODWILL AMORTIZATION

Abstract: Current U.S. GAAP mandates amortizing goodwill over no more than 40 years. Although many commentators suggest that 40 years is an arbitrary time span, there is a Biblical basis for 40-year amortization. The Bible refers to 40 years as the life of a generation. Since amortizing goodwill over no more than 40 years corresponds to amortizing it over no more than one generation of talented employees or customers, the process is not completely arbitrary

Goodwill is an asset because it represents future economic benefits, often attributable to a talented work force or a favorable customer following. Under current GAAP, Accounting Principles Board Opinion No. 17, "Intangible Assets" (APB 17), goodwill acquired after October 31, 1970 must be amortized over a period not to exceed 40 years.[1]

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[1]In 1999, the Financial Accounting Standards Board (FASB, 1999, para. 42) proposed to reduce the maximum goodwill amortization period to 20 years.

Both the APB and subsequent commentators have suggested that the 40-year goodwill maximum amortization period is a completely arbitrary time span. There is a Biblical basis, however, for this amortization period. The Bible suggests that the life of a generation does not exceed 40 years. To the extent that goodwill is attributable to a talented work force or a favorable customer following, amortizing goodwill over no more than 40 years corresponds to amortizing it over no more than one generation of talented employees or customers. Accordingly, this 40-year period is not a completely arbitrary time span.

NATURE, RECOGNITION, MEASUREMENT, AND AMORTIZATION OF GOODWILL

In accounting for goodwill, it is useful to distinguish among its nature, recognition, measurement, and subsequent amortization.[2]

Nature of Goodwill: FASB Concepts Statement No. 6 [1985, para. 25] defined an asset as probable future economic benefits obtained or controlled by a particular entity as a result of a past transaction or event. Three essential characteristics of an asset were noted [FASB, 1985, para. 26]:

(a) It embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows.

(b) A particular entity can obtain the benefit and control others' access to it.

[2]Unfortunately, many commentators have defined goodwill without distinguishing among its nature, recognition, and measurement. For example, Cooper and Ijiri [1983, p. 238] defined goodwill as:

1. The current value of expected future income in excess of a normal return on the investment in net tangible assets; not a recorded or reported amount unless paid for.

2. The excess of the price paid for a business as a whole over its book value, or over the computed or agreed value of all tangible [and identifiable intangible] net assets purchased.

The first definition defines goodwill in terms of its measurement (i.e., its current value) and then summarizes the recognition rule that goodwill is not recorded or reported unless paid for. The second definition also defines goodwill in terms of its measurement as an excess.

(c) The transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.[3]

In its 1999 Exposure Draft, "Business Combinations and Intangible Assets," the FASB [1999, paras. 180-185, 190] concluded that goodwill meets the asset definition in SFAC No. 6:

(a) Goodwill is an asset because it embodies future economic benefits.
(b) The economic benefits are nebulous but are reflected by the premium an enterprise commands over the sum of the fair value of its component parts.
(c) Control over the benefits is provided by the acquiring enterprise's ability to direct the policies and management of the acquired enterprise.
(d) The past transaction or event is the transaction in which the controlling interest was obtained by the acquiring enterprise.

Recognition of Goodwill: Under GAAP, goodwill is recognized when it is purchased. Purchase usually occurs when there is a significant change in ownership. A change in ownership results in a new accounting entity, which in turn necessitates a new basis for net assets purchased, including the recognition of goodwill. For publicly owned corporations, the most common change in an accounting entity results from a purchase-type business combination. Goodwill usually is recognized in business combinations under purchase accounting. It is also recognized by subsidiaries issuing separate company financial statements under push-down accounting following a significant change in ownership, and may be recognized incident to the admission or withdrawal of a partner from a partnership. The measurement and amortization of goodwill are separate issues.

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[3]SFAC No. 6 also noted that an asset commonly has other features that help identify it; for example, an asset may be tangible, exchangeable, or legally enforceable, but these features are not essential characteristics of assets, and their absence, by itself, is not sufficient to preclude an item's qualifying as an asset. That is, an asset may be intangible, nonexchangeable, and the entity's rights to obtain its benefits may not be legally enforceable.

Measurement of Goodwill: Under APB 16 [1970, para. 87], goodwill is measured as the excess of the price paid for a business as a whole over the fair value of its identifiable net assets. That is, goodwill is measured as the excess of the cost of an acquired business over the fair value of the tangible and identifiable intangible assets acquired less liabilities assumed.[4] Because goodwill is measured as an excess or residual, accountants have long understood [e.g., Canning, 1929, pp. 42-43] that reported goodwill is a master valuation account. That is, the amount reported for goodwill is intertwined with the amount reported for all other assets acquired and liabilities assumed. Given the cost of an acquired business, the lower the amounts reported for the identifiable assets acquired (and the greater the amounts reported for the liabilities assumed), the greater the amounts assigned to goodwill, and vice versa.

Amortization of Goodwill: Presumably, the recognition and measurement of goodwill as an asset presuppose that it is an asset in the first place. The amortization of goodwill is a separate issue. This paper is concerned mainly with the rationale for the maximum 40-year amortization of goodwill under APB 17, not the nature, recognition, or measurement of goodwill.

PRACTICE PRIOR TO *APB OPINION NO. 17*

Before APB 17, the accounting for goodwill was prescribed by Accounting Research Bulletin No. 43, "Restatement and Revision of Accounting Research Bulletins" [ARB 43, ch. 5]. Under ARB 43, goodwill was considered a type (b) intangible asset with indefinite life. As a type (b) intangible asset with indefinite life, goodwill cost was either:

(1) capitalized until a limit on its useful life or a loss of value was evident, at which time it was amortized or, if worthless, written off as an extraordinary loss; or
(2) amortized to expense at the discretion of management even though no present evidence pointed to a limited term of existence or a loss of value.

[4]In an Exposure Draft, the FASB [1999, para. 21] reaffirmed this approach to measuring purchased goodwill.

Criticism of the accounting for goodwill under ARB 43 centered on the acceptability of alternative accounting methods. Some companies amortized goodwill over a short arbitrary period to reduce the amount of the asset as rapidly as practicable. This practice was criticized because it understated income during the amortization period and overstated income in subsequent periods. Other companies retained goodwill as an asset until evidence of loss of value was apparent, and then recorded a material reduction in a single period. This practice was criticized because it overstated income before the loss was recognized and understated income in the period of write-off.[5]

APB OPINION NO. 17: RATIONALE FOR REQUIRED AMORTIZATION

Under APB 17 [1970, para. 27], goodwill acquired after October 31, 1970 was to be amortized by systematic charges to income over its useful life. (Goodwill acquired before October 31, 1970 continued to be subject to the accounting requirements of ARB 43.) Useful life was estimated over a range with upper and lower limits when fixed existence was not determinable, but the amortization period was not to exceed 40 years. APB 17 [para. 29] also noted that when the indeterminate life of an intangible asset such as goodwill was likely to exceed 40 years, the asset was to be amortized over 40 years, not an arbitrarily shorter period.

APB 17 [para. 23] required amortization of goodwill on what it termed an arbitrary basis. It [paras. 22-23] reasoned that even when there was no evidence of limited life or decreased value, amortizing goodwill on an arbitrary basis might recognize expense and asset decrease prematurely, but delaying amortization until a loss was evident might recognize expense and asset decrease after the fact. A practical solution, APB 17 [para. 23] concluded, was to set minimum and maximum amortization periods. It based this conclusion on the observation that few, if any, intangible assets last forever, although some might seem to last indefinitely. Amortizing goodwill was necessary, according to APB 17 [para. 23], because goodwill inevitably disappears at some

[5]At various times, the Securities and Exchange Commission (SEC) urged the APB to make the accounting for goodwill more uniform. According to minutes of the September 10-13, 1969 APB meeting [APB, 1969, p. 3], the SEC made known to the APB that it favored mandatory amortization of goodwill over a period of about 33 years.

future date. Since that date is indeterminate, the amortization period is arbitrary.

OTHER LITERATURE

Various writers have commented on the arbitrariness of 40-year amortization of goodwill under APB 17. For example, Kieso and Weygandt [1998, p. 596, emphasis added] noted that the 40-year amortization requirement was based on the premise that only a few, if any, intangibles last forever: "Sometimes, because useful life is difficult to determine, a 40-year period is employed because it is practical, although admittedly *arbitrary*."

Similarly, Hendriksen and Van Breda [1992, p. 645, emphasis added] noted that "[t]his 40-year period is *arbitrary* and can be defended only on the basis that it is long enough so that the income of no period is significantly affected. The effect is to neutralize or sterilize the allocation of goodwill with respect to the information presented to investors and creditors."[6]

BIBLICAL BASIS

Although the APB and various commentators suggested that the 40-year amortization period is completely arbitrary, the Bible suggests that 40 years is a time period of special significance and that the life of a generation does not exceed 40 years.

Significant Time Span: The Bible [New World Bible, 1984] is replete with references to 40 years as a time period of special significance. Isaac and Esau married at 40 [Genesis, 25:20, 26:34]. A man was full-grown at 40 [Exodus, 2:11; Acts, 7:23; cf. Joshua, 14:7; Samuel, 2:10]. At age 40, Moses defended his oppressed brethren and struck the Egyptian taskmaster [Acts, 7:23].[7] After another 40

[6]Hendriksen and Van Breda [1992, p. 645, emphasis added] also noted that "[n]ot every one has agreed with the 40-year term for the amortization of goodwill. For instance, banking authorities and the SEC require banks and thrifts to write off unidentified intangibles, such as goodwill, over a period not to exceed 25 years. . . The Australian Accounting Research Foundation has proposed a maximum of 20 years for goodwill. Businesses, on the other hand, have argued that 50 to 100 years would be more appropriate. Since no theory exists to guide the choice, whatever period is selected is inherently arbitrary."

[7]Forty years is also a time span of special significance in several other civilizations. Forty years is the age when Buddha began preaching and the beginning of old age in Japan [see "Properties," n.d.]. In ancient Rome, it took 40 years of hard fighting in Latium and Etruria to restore Rome's power after Rome was sacked by and then ransomed from a marauding Gallic tribe in 390 BC. In modern Turkey, to see someone "once in 40 years" means to see someone "rarely" [Cooper, 1987, p. 18].

years, an angel appeared to Moses in the wilderness of Mount Sinai in a flame of fire in a bush [Acts 7:30]. Saul reigned as king for 40 years [Acts 13:21]. The 40-year reigns of David, Solomon, and Joash [2 Samuel, 5:4; 1 Kings, 2:11, 11:42; 1 Chronicles 29:26; 2 Chronicles, 9:30, 24:1] are proof of divine favor. The lame man that Peter raised up and made to walk as a divine sign was more than 40-years-old [Acts: 3: 7, 23].

Eighty (or two times 40) years were ripe old age [II Samuel, 19:34-35; Psalms, 90:10]. Moses was age 80 when he was summoned by the Lord to be His messenger to tell Pharaoh to free the Israelites [Exodus, 7:7]. Eighty years was the term of Joseph's service to Pharaoh [Genesis, 41:46, 50:26]. One hundred twenty (or three times 40) years was maximum life span [Genesis, 6:3]. Moses was age 120 when he died [Deuteronomy, 34:7].

Life of Generation: The Bible [New World Bible, 1984] is also replete with references to 40 years as the approximate life of a generation.[8] Most prominent is the 40-year period the ancient Israelites spent in the Sinai wilderness [Exodus, 16:35; Deuteronomy, 2:7, 8:2, 29:5; Joshua, 5:6; Nehemiah, 9:21; Psalms, 95:10; Amos, 2:10, 5:25; Acts 7:36, 7:42, 13:18; Hebrews, 3:9, 3:17] until a corrupted generation died out [Numbers, 14:33, 32:13]. The generation was corrupted by reports of ten of 12 spies who spent 40 days scouting the land of Canaan. Ten of the 12 spies reported that the inhabitants of Canaan were too strong for the Israelites to conquer. Based on these unfavorable reports, most of the Israelites lost faith in the Lord's promise to give them the Land

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In Islam, the Koran is replete with references to 40 years as a period that is especially meaningful. Forty years is the age at which man attains his full strength [Shakir, 1983, 46:15], and the age at which Mohammed received his call [Bridgewater, 1967, p. 1397]. It is also the age of Mohammed's first wife at marriage [Gibb, 1974, p. 280], and the age at which Abu Baqr converted, assuming that he converted three years after Mohammed received his call.

[8] The Bible itself repeatedly refers to 40 years as the approximate life of a generation. On the other hand, average life span in Biblical times no doubt reflected high childhood mortality. Assuming two linear distributions, if average life span in Biblical times was 40 years and half the population lived an average of ten years, average life span of those surviving childhood (X) would be 70 years; hence, the Biblical reference [Psalms, 90:10] to three score and ten as average life:

$$\begin{aligned} .5(X) + .5(10 \text{ yrs.}) &= 40 \text{ yrs.} \\ .5X + 5 \text{ yrs.} &= 40 \text{ yrs.} \\ .5X &= 35 \text{ yrs.} \\ X &= 70 \text{ yrs.} \end{aligned}$$

of Canaan notwithstanding His delivering them with signs and miracles from Egypt. Initially, the Lord proposed to strike the Israelites with pestilence and disown them because they lost faith in Him despite His signs and miracles as he brought them forth out of the land of Egypt. But Moses pleaded with the Lord, seeking the Lord's forbearance for the Israelites, and the Lord relented. The Lord decreed, however, that not one Israelite over age 20 who lost faith would enter the Promised Land. Rather, He decreed that those that lost faith should wander and die in the Sinai over a 40-year period. Only after this 40-year period would their children leave the Sinai and enter the Promised Land. Thus, this 40-year period corresponds to the time the ancient Israelites spent in the Sinai wilderness until the corrupted generation died out.

Forty years is also the time span Ezekiel prophesized that the land of Egypt would be desolate and the Egyptians dispersed among the nations as punishment for their ill treatment of the Israelites and for Pharaoh's arrogance [Ezekiel, 29:1-11]. Presumably, this 40-year period corresponds to the time the ancient Egyptians would spend scattered among the nations until that corrupted generation also died out.

Similarly, 40 years of peace followed the victory of Othniel and the Israelites over the Mesopotamians [Judges 3:9-11] and the victory of Gideon and the Israelites over the Midians [Judges 8:28]. On the other hand, there was 40 years of Philistine oppression of the Israelites in punishment for their evil ways following the death of Abdon [Judges, 13:1]. And there was 40 years of misrule by Eli culminating in the defeat of the Israelites and capture of the covenant ark by the Philistines [1 Samuel, 4:1-18]. These 40-year rules of the tribal chieftains [Judges 3:11, 8:28, 13:1; 1 Samuel, 4:18] represent roughly one generation each. The 80 years of peace following the victory of the Moabites [Judges, 3:30] represents roughly two generations. The Bible counts the 480 years from the Exodus to the building of the temple [1 Kings 6:1] as 12 generations in 1 Chronicles [6:3-8].[9]

[9]There are several interpretations of 1 Chronicles [6:3-8] as to why the period from the Exodus to the building of the temple spans 12 generations. One interpretation is that Aaron, Eleazar, and Phineas were alive at the start of the Exodus; hence, these generations should be excluded from the other enumerated generations, leaving 12 generations. Another interpretation is that the number of generations from the Exodus to the building of the temple is counted by excluding the first and the last generations, leaving 12 generations. Still another interpretation is a rabbinic commentary [*Metzudas David*, n.d., of 1 Chronicles (5:29-34) of the

Thus, the 40-year period is not a completely arbitrary time span. Forty years corresponds to the maximum life of a generation. Moreover, a 40-year period is distinguishable from other round-numbers of years. For example, 30 years is less than one generation, and 50 years is more than one generation. Thus, the 40-year period in Israel's history was of real-world significance. The source and significance of the 40-year period in Judeo-Christian civilization stems from this Biblical basis.

APPLICABILITY TO GOODWILL AMORTIZATION

Goodwill is an asset because it represents future economic benefits, often (although not always) due to a talented work force or a favorable customer following for some given products and services. The cost of goodwill should be amortized over its expected useful life.

To the extent that goodwill is attributed to a talented work force or a favorable customer following, its maximum useful life cannot exceed the remaining service lives of its work force or the remaining lives of its customers. That is, to the extent that goodwill is attributed to a talented work force or a favorable customer following, its maximum useful life cannot exceed one generation of talented employees or customers.[10]

As noted above, the Bible is replete with suggestions that the life of a generation is 40 years. Two former APB members recollected vague connections of the APB 17 40-year maximum rule and the Israelites' 40-year sojourn in the Sinai desert. In a telephone conversation, Sidney Davidson said that "he heard the

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Hebrew version of the Bible], which (redundantly) included the same enumeration of generations as found in 1 Chronicles [6:3-8] but was not included in the King James version of the Bible. This commentary stated explicitly that the high priesthood passed from father to son for 12 generations from the Exodus to the building of the temple.

[10]To the extent that goodwill is attributable to other unrecorded intangible assets, more of the purchase price should be allocated to these assets and less to goodwill. Any remaining goodwill may be attributable to other factors, such as ongoing research and development projects, brand names, marketing campaigns, or favorable asset configurations. To the extent that goodwill is attributable to other factors, it should be amortized over the useful lives of these other factors, usually less than 40 years. But this paper focuses on the correspondence of the 40-year maximum amortization period under APB 17 and one generation of employees or customers. These other factors are not germane to this correspondence as a rationale for the 40-year amortization rule under APB 17.

story" that the APB considered the Israelites' 40-year sojourn in the Sinai desert in its deliberations on goodwill amortization, but does not recall the source of the story or the APB member who introduced it into the deliberations. Similarly, Charles Horngren suggested that the APB 17 40-year maximum rule and the Israelites' 40-year sojourn in the Sinai desert might have been some side comment during the APB's deliberations, but he did not know the source of the side comment. Thus, the 40-year amortization rule under APB 17 has links to the Biblical suggestion that a generation is 40 years.

Indeed, Philip Defliese, APB chairman when APB 17 was issued, was quoted by an anonymous reviewer as noting that, ". . . the 40-year amortization period was to correspond to the assumed working life of the youngest employee at the time of acquisition . . . . that any goodwill attributable to employees must die out by the time the last one leaves . . . ." Thus, even the former APB chairman viewed the 40-year amortization period as corresponding to the maximum service period of one generation of employees.[11]

CONCLUSION

To the extent that goodwill is attributed to a talented work force or a favorable customer following, its maximum useful life is approximately one generation of employees or customers. As first suggested in the Bible and then elsewhere, the life of a generation is approximately 40 years. Accordingly, the 40-year maximum amortization period of APB 17 has a real-world significance suggested initially in the Bible. It is not a completely arbitrary time span.

[11]Admittedly, in a rapidly changing business world, the average period individual employees work for a single employer is growing shorter, as is the average life cycle of products and services for which there is a favorable customer following. But the maximum 40-year amortization rule of APB 17 was developed in the late 1960s and finalized in 1970, a far less rapidly changing era. In this less rapidly changing era, the average period individual employees worked for a single employer frequently was their entire career, often 40 years or thereabouts. Similarly, in the less rapidly changing era of the late 1960s, the average life cycle of products and services was longer, suggesting a longer time span for a favorable customer following. The 40-year amortization period may well correspond to maximum useful life of goodwill in a less rapidly changing era of the late 1960s.

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