Financial Reporting Project #2: Long-Term Liabilities

Based on your previous analysis of property, plant and equipment, you have quickly become recognized as the accounting expert at your company. One of the advantages of this recognition is that you have been assigned more analyses to perform (with no comparable increase in pay). Your latest assignment involves providing an analysis of the components of long-term debt on Johnson and Johnson's **1997 Annual Report**. (Relevant financial information can be found at the Johnson and Johnson homepage located at http://www.jnj.com). Specifically, your boss wishes for you to prepare a short memorandum answering the following questions. Reference the sources of information (e.g. balance sheet, income statement, footnote #1) used in answering the following questions and show all relevant calculations.

1. How much debt has Johnson and Johnson classified as "long-term" as of 12/28/97?

2. Consider the 8.72% debentures due in 2024.
   a) What is mean by the term "debenture"?
   b) Are these debentures selling at par, at a premium, or at a discount? How can you tell?

3. Consider the 7 3/8% notes due 2002.
   a) Are these notes selling at par, at a premium, or at a discount? How can you tell?

   For Parts B and C: Assume the market interest rate at the time the bonds were issued was 7.49%.
   b) What is an estimate of interest expense related to these notes for 1997? Show any relevant calculations.
   c) Assume the book value of the notes on 12/28/97 equals $199,069,199.22. Prepare an amortization schedule (using a computer spreadsheet) for the remaining life of the bonds (assume the maturity of the bonds is $200,000,000).

Analysis

4. Because of recent increases in the market rate of interest, Johnson and Johnson's management is considering retiring the 6.73% debentures due in 2023. Because these debentures were issued at par, their book value is $250,000,000. The current market rate of interest for bonds with these risk characteristics is 12%, and the 6.73% debentures are currently selling at $145,974,478. Instead of purchasing these debentures in the open market, one of Johnson and Johnson's financial staff has suggested a debt-for-debt swap – swap the 6.73% debentures for 12% debentures. To encourage the bondholders to swap the bonds, Johnson and Johnson would have to provide a "sweetener" (cash payment) of approximately $20,000. This inducement would take the form of issuing bonds with a principle amount of $145,994,478 ($20,000 higher than the market value of the bonds being retired) to retire the 6.73% debentures. Evaluate the options faced by Johnson and Johnson and provide a suggested course of action with regard to this situation (ignore tax considerations).