Instructions.

This exam is 100 minutes long. Upon receiving the exam, you should write your name and circle the time at which you are taking the exam. Then read the remainder of this page and stop.

Do not proceed beyond this cover page till you are told to do so by the instructor or the TA.

1. This exam has 4 questions and 9 (nine) pages. **Check your copy of the exam to make sure you have a complete copy.**
2. All questions have equal weight. Use your time well: do the easy parts first.
3. Show all your work wherever possible. It may help you earn partial or substantial credit.
4. Please note that there is substantial white space between problems to allow you plenty of room to write your answers and show your work on the printed side of each page of the exam. **Do not write answers for which you expect to earn a grade on the backs of pages** (you may use those for additional scratch work if you like).
5. **Make sure you read all pages of the exam and follow instructions exactly. If answers are illegible, incomprehensible or written down in the wrong place, we may fail to evaluate them correctly.**
6. The exam is closed book, no-notes. Only numeric calculators should be used. Text-storing calculators may be used only if you have purged all stored text. You may use electronic dictionaries if your native language is not English. Students are presumed to be familiar with the Code of Policies and Regulations Applying to All Students. In particular, please the following provision (ibid, §33): “It is the responsibility of the student to refrain from infractions of academic integrity, from conduct that may lead to suspicion of such infractions, and from conduct that aids others in such infractions.” **Detected violations of academic integrity will result in a score of zero for this exam as well as additional disciplinary action consistent with University policy.**
7. No questions will be answered during the exam. **If you cannot understand some part of the exam, if you find a typographical error or if you believe the exam is in any way erroneous or unworkable, please state your difficulty in writing on the exam itself.**
8. This exam is a test of your individual knowledge and ability to complete the assigned tasks at this moment in time. **You may not consult anybody regarding any portions of the exam before you turn it in to the instructor or the TA.**
9. If you need to leave the room during the exam for personal reasons, you may do so after seeking the permission of the instructor or TA. Before leaving your seat, please make sure that your exam is closed and turned over so that no writing is visible. You should turn off or put away your calculators/dictionaries as well.
Question 1
On Dec. 31, 2004, the Busey Bank enters into a debt restructuring agreement with Legend Company, which is now experiencing financial trouble. The bank agrees to restructure a 12%, issued at par, $2,000,000 note receivable by the following modifications:

- Reducing the principal obligation from $2,000,000 to $1,600,000
- Extending the maturity date from December 31, 2004 to Dec. 31, 2007
- Reducing the interest rate from 12% to 10%

Legend pays interest at the end of each year. On Jan. 1, 2008, Legend Company pays $1,600,000 in cash to Busey Bank.

Required:

A. Assuming that the interest rate Legend should use to compute interest expense in future periods is 1.4276%, prepare the interest payment entry for Legend Company on December 31, 2006.
B. Use the same information above except that Busey Bank reduced the principal to $1,300,000 rather than $1,600,000. On Jan. 1, 2008, Legend pays $1,300,000 in cash to Busey Bank for the principal. Prepare the interest payment entry for Legend Company on Dec. 31, 2006.
Question 2

The original sale of the $50 par value common shares of Eddy Company was recorded as follows:

\[
\begin{align*}
\text{Cash} & \quad \text{290,000} \\
\text{Common Stock} & \quad \text{250,000} \\
\text{Paid-in Capital in Excess of Par} & \quad \text{40,000}
\end{align*}
\]

Required:
Record the treasury stock transactions (given below) under the cost method:

Transactions:
(a) Bought 500 shares of common stock as treasury shares at $62.
(b) Sold 120 shares of treasury stock at $60.
(c) Sold 60 treasury shares at $68.
Question 3

Fairly Co. had 200,000 shares of common stock, 20,000 shares of convertible preferred stock, and $1,000,000 of 10% convertible bonds outstanding during 2004. The preferred stock is convertible into 40,000 shares of common stock. During 2004, Fairly paid dividends of $1.20 per share on the common stock and $4.00 per share on the preferred stock. Each $1,000 bond is convertible into 45 shares of common stock. The net income for 2004 was $800,000 and the income tax rate was 30%.

Required:

A. Basic earnings per share for 2004 is (rounded to the nearest penny)

B. Diluted earnings per share for 2004 is (rounded to the nearest penny)
Question 4

Reproduced below is a part of a Jan 17, 2003 Money magazine article on Microsoft’s dividend plan. Read it and answer the question below the article.

On Jan. 16, 2003, Microsoft shocked Wall Street by announcing that it would pay a dividend on common stock for the first time ever. The annual dividend, equal to 16 cents a share before the split, would amount to a yield of about 0.3 percent based on its stock price. For the full fiscal year, Microsoft said it expected revenues to be in the range of $31.9 billion to $32.1 billion, lower than the consensus estimate of $32.5 billion. The company lowered its earnings target as well, saying it expected to earn between $1.90 and $1.93 a share. Analysts were expecting $1.98 a share. The new estimates call for earnings growth of between 4 and 5.5 percent from fiscal 2002.

During a conference call on that evening, Microsoft Chief Financial Officer John Connors said that the business environment remained "challenging." Connors said that the company is expecting personal computer shipments to increase in the low to mid single digits for the rest of its fiscal year. "There is not much change in the health of the PC ecosystem. Demand from business customers continued to be challenging. We did not see robust corporate demand," Connors said.

The announcement of the dividend seemed to get as much attention as the earnings. "I was surprised that they came out this soon and announced. It's really just a token one, but there's room for it to increase," said Drake Johnstone, an analyst with Davenport & Co. Johnstone does not own shares of the stock and his firm has no investment banking relationship with Microsoft. To that end, Connors said during the conference call that the dividend was just a "starter dividend." He added that the dividend payment will not affect the company's strategy of buying back shares when it sees fit. In the last quarter, Microsoft repurchased 19 million shares, worth about $1 billion.

Discuss why management might have started to pay a dividend and what impact the decision might have on Microsoft’s business strategy.