Question 1

A. The interest payment schedule is prepared as follows:

LEGEND COMPANY

INTEREST PAYMENT SCHEDULE AFTER DEBT RESTRUCTURING

EFFECTIVE INTEREST RATE 1.4276%

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash</th>
<th>Interest (10%)</th>
<th>Effective Interest (1.4276%)</th>
<th>Reduction of Carrying Amount</th>
<th>Carrying Amount of Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/04</td>
<td>$2,000,000</td>
<td>$160,000</td>
<td>$28,552</td>
<td>$131,448</td>
<td>$1,868,552</td>
</tr>
<tr>
<td>12/31/05</td>
<td>$160,000</td>
<td>$160,000</td>
<td>26,675</td>
<td>$133,325</td>
<td>1,735,227</td>
</tr>
<tr>
<td>12/31/06</td>
<td>$160,000</td>
<td>$160,000</td>
<td>24,773d</td>
<td>135,227</td>
<td>1,600,000</td>
</tr>
<tr>
<td>Total</td>
<td>$480,000</td>
<td>$480,000</td>
<td>$80,000</td>
<td>$400,000</td>
<td></td>
</tr>
</tbody>
</table>

*a*  $1,600,000 \times 10\% = $160,000.

*b*  $2,000,000 \times 1.4276\% = $28,552.

*c*  $160,000 - $28,552 = $131,448.

*d* Adjusts $1 due to rounding.

Interest payment entry for LEGEND Company is:

December 31, 2006

Note Payable 133,325
Interest Expense 26,675
Cash 160,000

B. Because the new carrying value of the note ($2,000,000 - $310,000 = $1,690,000) equals the sum of the undiscounted future cash flows ($1,300,000 principal + $390,000 interest = $1,690,000), the imputed interest rate is 0%. Consequently, all the future cash flows reduce the principal balance and no interest expense is recognized.
Cash interest payment entries for LEGEND Company are:


<table>
<thead>
<tr>
<th>Note Payable</th>
<th>$130,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$130,000</td>
</tr>
</tbody>
</table>

Question 2

(a) Treasury Stock ........................................ 31,000
    Cash ................................................... 31,000

(b) Cash ............................................. 7,200
    Retained Earnings .................................. 240
    Treasury Stock ...................................... 7,440

(c) Cash ............................................. 4,080
    Paid-in Capital from Treasury Stock .............. 360
    Treasury Stock ...................................... 3,720

Question 3

(a) Basic = \[ \frac{\$800,000 - (20,000 \times \$4)}{200,000} \] = $3.60.

(b) Diluted = \[ \frac{\$800,000 + (\$1,000,000 \times .10 \times .7)}{200,000 + 45,000 + 40,000} \] = $3.05.