

B-13.14

Mike Davis Company entered into two lease agreements. One lease was for office space and the other was for office equipment.

The office space lease is not a capital lease. It is an operating lease because the risks and rewards of owning the property remain with the lessor (owner of the property). The lease agreement is for 5 years and provides for monthly payments of \$2,500. These rent payments are charged to rent expense as incurred. No liability is recorded for the lease contract.

The office equipment lease is a capital lease. This lease is also for 5 years. Payments at the end of each month are \$2,500, and their present value at the inception of the lease is \$112,388. The interest rate implicit in the lease is 1% per month.

- (a) Prepare the journal entry needed to record a payment under the office space lease.
- (b) Prepare the initial journal entry to record the office equipment lease.
- (c) Prepare the journal entries necessary to record the first and second payments under the office equipment lease.
- (d) Assuming straight-line depreciation over 60 months, prepare the journal entry to record monthly depreciation of the office equipment.
- (e) How would the financial reporting differ for the office space versus the office equipment?