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 <u>not</u> a financing 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 financing 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?