Sophie Rose, owner of Rose Designs, the interior design company we previously introduced, has decided to invest $20,000 cash in her business. In exchange for her cash contribution, the corporation will issue common stock to Sophie. We will use the expanded accounting equation to evaluate how this transaction affects the business:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **ASSETS** | **=** | **LIABILITIES** | **+** | **STOCKHOLDERS’ EQUITY** | | | | | | |
|  |  |  |  |  |  |  | **Retained Earnings** | | | | |
|  | Cash | = |  | + | Common  Stock | − | Dividends | + | Revenues | − | Expenses |
| (1) | +20,000 |  |  |  | +20,000 |  |  |  |  |  |  |

Following table illustrates the impact of this transaction on the "Financial Statements" of Rose Designs:

|  |
| --- |
| This table will be replaced by Leonardo item |
|  |
|  |

Let’s take a close look at this transaction above following these steps:

### Step 1: Identify the accounts and account type.

Each transaction must affect at least two accounts but could affect more than two. The two accounts involved in this transaction are Cash (Asset) and Common Stock (Stockholders’ Equity).

### Step 2: Decide if each account increases or decreases.

Remember to always view this from the business’s perspective, not from the stockholders’ or customers’ perspective. Cash increases. The business has more cash than it had before. Common Stock increases. The business received a $20,000 contribution and issued stock.

### Step 3: Determine the impact on the financial statements.

The balance sheet reflects a $20,000 increase to the asset, Cash, and to stockholders’ equity, Common Stock. The statement of cash flows, financing, is increased by $20,000.

In the next topic we will see why would a company choose equity financing over debt financing?

## Test your understanding