

# Retained Earnings for Sole Traders

*How to read the bottom of your balance sheet, **line by line**.*

## The short answer

Retained Earnings is the profit that your business made in previous years that you've left in the business rather than taken out.

You'll find it at the bottom of your balance sheet, under Capital and Reserves. That section shows your stake in the business - what the business would owe you if everything were settled up today. Retained Earnings is one part of it, and it sits alongside a few other lines that are worth understanding too.

## A real example, line by line

Here's the Capital and Reserves section from a sole trader's balance sheet.

| Line                           | Amount  | What it means                                                                                                           |
|--------------------------------|---------|-------------------------------------------------------------------------------------------------------------------------|
| Retained Earnings              | £30,000 | Profit from previous years that has been left in the business                                                           |
| Profit for the year            | £4,000  | Profit made so far this year                                                                                            |
| Drawings                       | £15,000 | Money taken out, less money put in. Here the owner has put in more than he/she has taken out, so it adds to their stake |
| Opening Balance Equity         | £0.00   | A setup account used when the books were started. It should be zero, and here it is                                     |
| Total for Capital and Reserves | £49,000 | The owner's total stake in the business                                                                                 |

## How the lines fit together

- Retained Earnings is the history - every past year's profit that stayed in.
- Profit for the year is this year's chapter. When the year is closed off, it moves into Retained Earnings and the count starts again from zero.
- Drawings usually reduces your stake, because it's money you've taken out for yourself. When you've paid more of your own money in than you've taken out, it adds to your stake instead, as it does here.
- The total always matches Total Net Assets further up the balance sheet. Everything the business owns, less everything it owes to others, belongs to you.

## Common mix-ups

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- Retained Earnings isn't cash. The profit you've left in may be tied up in equipment, stock, or money that customers still owe you.
- Leaving profit in doesn't save tax. You pay Income Tax and National Insurance on all of your profit, whether you take it out or not.
- Drawings aren't a business expense. They don't reduce your profit or your tax bill.

### KEY TAKEAWAY

*Retained Earnings is the profit you've built up over the years and chosen to leave in. Add this year's profit and your net drawings, and you have your total stake in the business. In this example, that's £49,000 the business owes its owner.*

## What to do next

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- Find Capital and Reserves at the bottom of your own balance sheet
- Check Opening Balance Equity is zero, and ask us if it isn't
- Book a free chat with us if you'd like a hand reading your accounts