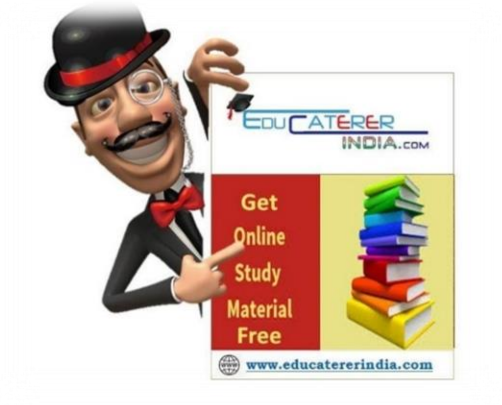
Difference Between Retained Earnings and Reserves



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Introduction

Risk and uncertainties are natural in all type of business and this will decide the future of the business. So, to meet this unexpected factor, retained earnings and reserves are arranged. Both are registered under the equity section in the balance sheet. The main difference between retained earnings and reserves is that in retained earnings, a part of net income which was left in the business after distributing dividends to the shareholders is included while reserves are a portion of retained earnings set aside for a future expectancy.

Retained Earnings

- Retained earnings are also called as the "retained surplus".
- Retained earnings are the combined earnings of the business since its founding.
- This is the share of the company's net gain which was left out after sharing dividend to the shareholders.
- The remaining amount is invested in the company for getting profitable returns which help to develop the company which is called accumulated profits, surplus, etc.
- Retained earnings come under the title of reserves and surplus.

- The main purpose to keep the retained earnings is to assure the solvency of the business and to meet a future emergency.
- The retained earnings of a company depend on the dividend pay-out ratio and the reservation ratio.
- Retained earnings are used either for the reinvestment or to pay debts.

Formula to calculate retained earnings

Retained Earnings = Beginning Retained Earnings + Net Income – Dividends

Reserves

- Reserves are a portion of the retained earnings which is allotted for the particular purpose.
- These are essentially used to meet unforeseen future loss if in case it occurs.
- Reserves are kept aside before distributing profits to the shareholders as a dividend and after paying taxes of the company
- The reserves are like writing off fictitious assets, distribution of dividend if profit does not occur, acquisition and replacement of assets, redemption of debentures or preference shares, bonus issue, etc.
- The main motive of the reserve is to make financial position strong for the future.

Types of reserves

1) Revenue reserve

- It is created out of the revenue profit and it is obtained in the normal course of business.
- It is used to make financial position strong, to replace depreciable assets, to redeem liabilities, to declare the stable rate of interest, to conduct research and development activity etc.
- If the revenue reserve is not needed in the future it is shared among the shareholders as a dividend.

2) Capital reserve

- A reserve which is created from the capital profit is known as the capital reserve.
- It is earned from the capital transactions and not from the normal course of business.
- The capital reserve is not made to distribute among the shareholders.
- A capital profit occurred from the capital transactions like Profit on sale of fixed assets, Profit on sale of investment, Profit on revaluation of assets and liabilities, Premium on issue of shares and debentures, Profit on re-issue of forfeited shares, Discount on redemption of debentures, Profit on a purchase of an existing business etc.

Difference Between Retained Earnings and Reserves

Basis	Retained earnings	Reserves
Meaning	Retained Earnings are a portion of company's net income that is left out after distributing dividends to shareholders.	Reserves are a portion of the retained earnings which is allotted for the particular purpose.
Aim	Retained earnings are kept aside by the company for reinvesting it in the main business.	Reserves are managed by the company to meet future unexpetency.
Current year profit	In retained earnings, Profit for the current year is added to retained earnings after distributing dividends to the shareholders.	In reserves, a percentage of current year's profit is transferred to the reserves before distributing a dividend.