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## ACCOUNTING TREATMENT AND FINANCIAL REPORTING OF CAPITAL PREMIUMS

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**Abstract.** In this article, a study is carried out on the accounting treatment of capital premiums. The following research aims to identify the essence of capital premiums (included in the national accounting regulation from 01.01.2020), the transactions that lead to the appearance of this patrimonial element, how to make accounting entries and financial reporting. The study is based upon scientific research methods, namely: the analysis of the legal framework governing the study, the information analysis, the comparison in order to identify distinctive features, the deduction of challenges. The study presents the accounting records for all situations that determine capital premiums both theoretically and through practical situations. The results of the research identified the existence of 2 terms in the regulation of the Republic of Moldova, namely: in the accounting regulation - capital premiums, in the Law on joint-stock companies - additional capital, which can lead to confusion both in the recognition and in the examination of the financial indicator for economic decision-making, which determines a need for unification within the regulations. The result of the study shows that the capital premiums are generated by the transactions related to the share capital, however, the correspondence of the accounting account of capital premiums is made with the accounting account related to the unpaid capital - at the establishment of the entity, with the accounting account related to the unregistered capital - when the share capital is increased and the conversion of bonds into shares, and also with the capital accounting account withdrawn upon the cancellation or resale of shares. The research results presented in the study contain the accounting records on the situations that determine the capital premiums and their financial reporting.

**Keywords:** *accounting, capital premiums, equity, owners, financial statements.*

**Rezumat.** În acest articol se efectuează un studiu privind tratamentul contabil al primelor de capital. Cercetarea are ca scop să identifice esența conceptului de prime de capital (fiind inclus în reglementarea contabilă națională din 01.01.2020), tranzacțiile care determină apariția acestui element patrimonial, modul de înregistrare în contabilitate și, desigur, modul de raportare financiară. În cadrul studiului sunt utilizate metode de cercetare științifică, cum

ar fi: analiza cadrului legal care guvernează studiul, sinteza informațiilor, compararea pentru a identifica trăsăturile distinctive, deducerea provocărilor. Studiul prezintă înregistrările contabile pentru toate situațiile ce determină prime de capital atât sub aspect teoretic cât și prin situații practice. Rezultatele cercetării au identificat existența în reglementarea Republicii Moldova a 2 termeni și anume: în reglementarea contabilă - prime de capital, în Legea privind societățile pe acțiuni - capital suplimentar, fapt ce pot genera confuzii atât la recunoașterea cât și la examinarea indicatorului financiar pentru luarea deciziilor economice, ce determină o necesitate a unificării în cadrul reglementărilor. Rezultatul studiului arată că primele de capital sunt generate de tranzacțiile aferente capitalului social, cu toate acestea corespondența contului contabil de prime de capital se realizează atât cu contul contabil aferent capitalului nevărsat - la înființarea entității, cu contul contabil aferent capitalului neînregistrat - la majorarea capitalului social și la convertirea obligațiunilor în acțiuni, dar și cu contul contabil de capital retras la anularea sau revânzarea părților sociale. Rezultatele cercetării prezentate în cadrul studiului conțin înregistrările contabile pe situațiile ce determină primele de capital și raportarea financiară a acestora.

**Cuvinte cheie:** *contabilitate, prime de capital, capital propriu, proprietari, situații financiare.*

### 1. Introduction

The following research consists of the study of capital premiums as a concept, the accounting entries regarding a capital premiums and last but not least, their reporting in financial statements. Why is the research conducted under the noted aspects? Capital premiums represent a new concept in the accounting regulation of Republic of Moldova beginning with 01.01.2020, that also affects the legislation regulating the share capital of the entity, such as the laws regarding the organizational-legal forms of the entities, specifically the Law on joint-stock companies [1] nr. 1134 with the subsequent amendments, the Law on limited liability companies [2] nr. 135. Moreover, being a new element in equity, it has a specific accounting treatment that was not performed until 01.01.2020 and a specific method of reporting in the financial statements from 2020 onwards. Examining the situations that determine the appearance of capital premiums as well as their usage methods arouse interest for entities. Furthermore, another aspect that imposes the need for the current study are the changes in the legislation on share capital (the change of the share capital can determine the appearance of the capital premiums), the minimum amount of which is not always the same, as it periodically undergoes reviews and adjustments. According to the terms of the Law nr. 18 of 20.02.2020 on the amendment of the Law on joint-stock companies which is applied from 01.01.2021, the share capital of the joint-stock company cannot be less than 600 000 lei and the increase will be carried out gradually as follows: at the end of 2021 the share capital of a joint-stock company cannot be less than 120 000 lei, at the end of 2022 - of 360 000 lei and at the end of 2023 - of 600 000 lei. Likewise, the appearance of capital premiums is determined not only by the change in the share capital, but also by the resale and cancellation of the stocks/shares redeemed. Last but not least, the national accounting regulation presents only the correspondence accounting accounts for capital premiums without presenting the transactions in which they are determined. Being a new concept, it is not yet thoroughly researched, so as to exclude the difficulties that can arise. Hence, the following research proposes an extensive study of the concept of capital premiums, the situations of their occurrence, the accounting registering and the presentation of financial statements.

## 2. Materials and Methods

The research begins with a rigorous documentation regarding conceptual approaches with reference to capital premiums, accounting treatment and their reporting. From a methodological point of view, we wanted to perform a review of the accounting normative framework starting with an exhaustive analysis of the provisions of the National Accounting Standards (NAS), General chart of accounts, as well as national legislation on organizational and legal forms of entities which deals with the subject of capital premiums. Throughout the research a few questions emerged: What are capital premiums? What are the situations/transactions that determine the patrimonial element of capital premiums? How does the reporting of capital premiums occur? These questions will be studied and researched by description below. In the course of the study there were used multiple methods of scientific research such as: the analysis of the legal framework governing the study, the synthesis of information, the comparison in order to identify distinctive features, the deduction of challenges, through which it was possible to present the related accounting records.

## 3. Results and Discussion

Without a doubt, in order to review the other aspects, firstly, it is required to know the concept of premium capitals [3]. The definition of premium capitals is established by the provisions of National Accounting Standard “Equity and liabilities” [4] - and represent *the surplus* (the favorable differences) between:

1. The effective value and the nominal value of the shares deposited in the share capital;
2. The nominal or the alienation value and the withdrawal value of the repurchased shares and subsequently canceled and disposed of;
3. The nominal value of the bonds and the nominal value of the shares in which they were converted.

Thus, through the notion in which premium capitals were defined, the national accounting regulation practically defines the situations/cases that determine their occurrences. In this context, the capital premiums appear as a result of incorporation and modification transactions (increase and decrease) of the share capital for resale of withdrawn shares/units and the conversion of bonds into shares.

As a result of the examination of the legislation in the field, it can be ascertained through article 38 paragraph 4 of the Law on joint-stock company [1], it is established that: if the value of contributions made on account of the payment of the shares exceeds the nominal (fixed) value of the placed shares, this exceeding constitutes the *additional capital of the company*.

Concerning the concept of capital premiums, it is worth mentioning that according to the Directive 2013/34/EU [5], they are defined by the notion of *emission premiums*.

As stated above, conclusions regarding different terms for capital premiums can be drawn, namely:

- *Capital premiums* in the national accounting regulations (National Accounting Standard “Equity and liabilities”) [4].
- *Additional capital* in the regulation regarding the organizational-legal form of the entities [1].
- *Emission premiums* in the European accounting regulation (Directive 2013/34/EU) [5].

Noticeably, making adjustments to unify the concepts addressed in various national regulations would also contribute to a proper treatment and a better understanding for the purpose of correct application. In this context, we suggest the usage of the notion *capital premiums* from the national accounting regulation and the laws regarding the organizational-legal forms of the entities (Law on joint-stock companies) [1]. The concept of capital premiums is contained both in the national and international accounting regulation and differs in its economic essence from the concept of additional capital, that currently has disappeared from the accounting regulation.

The following research will be based upon the accounting treatment and the financial reporting of capital premiums, as established by the national accounting regulations, in other words regarding the entities that organize the accounting according to the National Accounting Regulations.

Subsequently, we will present the research on each situation/cause that determines capital premiums, as stated in National Accounting Standard "Equity and liabilities" [4].

According to the General chart of accounts [6], the passive account 317 "Capital premiums" is used for generalizing information on the existence and modification of capital premiums. The decrease/settlement of the capital premiums is registered in the debit of the account, while the appearance/increase of capital premiums is recorded in the credit of the account. The credit balance represents the existing amount of capital premiums at the end of the management period determined according to national accounting standards.

*The first situation that determines capital premiums is: the surplus (the favorable differences) between: the effective value and the nominal value of the shares deposited in the share capital.*

In the activity of entities, there can occur situations when the effective value of the assets (both goods and cash) deposited as a contribution to the share capital exceeds the amount of the contribution (the nominal value) owed by owners. In this situation, based upon the decision of the authorized management body, the difference can be considered (the point 10, National Accounting Standard "Equity and liabilities") [4]:

- as capital premium, if the difference is not to be returned to the owners;
- as liabilities towards owners, when the difference is to be returned to the owners.

Moreover, there will be presented the situation of the surplus between the effective value and the nominal value of the shares deposited in the share capital at its formation. It is worth mentioning, that the surplus between the effective value and the nominal value of the shares deposited in the share capital can occur both at *the incorporation of the entity* [7, 8] and at *the increase of the share capital of the entity*, although the accounting entries for capital premiums will be different [9].

The surplus (the favorable differences) between the effective value and the nominal value of the shares deposited in the share capital when the entity is established, it is reflected in the accounting entries:

*Debit account 313 "Callable capital"*

*Debit account 317 "Capital premium"*

Establishing the excess amount between the effective value and the nominal value of the shares deposited in the share capital is determined by the provisions of the normative acts, which stipulate that the founding of a joint-stock company at a price lower than their nominal value is not permitted or, if the nominal value is not established in the company contract, at a price lower than their fixed value (art. 23 par. 3 of Law on joint-stock companies)

[1] and for limited liability companies the total amount of contributions may not be less than the amount of the share capital (art. 22 par. 6 of Law on limited liability companies) [2].

If the act of incorporation or the decision of the general meeting of shareholders/associates stipulates that the contribution must be higher than the nominal value of the share, the ratio between the nominal value of the share and the contribution must be the same for all shareholders/associates (art. 42 par. 3 of Law on joint-stock companies, art. 24 par. 2 of Law on limited liability companies) [1, 2].

Due to the fact that the accounting entries related to capital premiums are not determined by individual economic transactions, but are determined by other transactions, below there will be presented situations with the indication of the accounting entries.

Instance for establishing a joint-stock company: At the foundation of the "Y" joint-stock company, there were placed 6 000 simple shares with a nominal value of 100 lei per unit. The shares were paid at a price of 110 lei per unit. Before the state registration, the shareholders paid the value of the shares with cash to the provisional bank account. The established company passed the registration of the shares placed in the share capital account at the National Commission of the Financial Market (NCFP). [10, 11].

Table 1

**The record book for economic operations**

Nº	Primary document	Economic operation content	Sum, lei	Accounts correspondence	
				Debit	Credit
1.	Decision of the Agency for Public Services, Company Contract, Status	Registration of unregistered capital at the incorporation of a joint-stock company, 6 000 shares x 100 lei	600 000	313	314
2.	Account statement, payment order	Recording of the collection of cash in the provisional account from the placement of the shares, 6 000 shares x 110 lei	660 000	244	313
3.	Decision of shareholders	Registration of capital premiums at the establishment of the company, 6 000 shares x (110-100) lei	60 000	313	317
4.	Decision of the National Financial Market Commission	Registration of the company's share capital after the registration of the placed shares at the NFMC, 6 000 shares x 100 lei	600 000	314	311

The surplus (the favorable differences) between the effective value of the owner's contributions submitted to the increase of the share capital and the nominal value of the shares is reflected in the accounting entries:

*Debit account 314 "Unregistered capital"*

*Credit account 317 "Capital premium"*

Instance regarding the increase of the share capital: According to the provisions of the contract for the establishment of the joint-stock company "Z", the share capital is 600 000 lei which is divided in 5 000 simple actions. An additional issue of 2 000 shares has been announced, which were placed at the price of 121 lei per share (the same price as at the establishment). The payment of the shares from the additional issue is made by transferring the cash to the bank account before the state registration takes place. The totals of the additional issue were registered at the National Financial Market Commission (NFMC) and the increase of the share capital of the joint-stock company passed the registration at the Agency of Public Services (APS) [10, 11].

Table 2

**The record book for economic operations**

Nº	Primary document	Economic operation content	Sum, lei	Accounts correspondence	
				Debit	Credit
1.	Account statement, payment order	Collection of cash from the additional issue of shares	242 000	242	314
2.	Decision of NFMC	Recording the nominal value of the shares from the additional issue (registered at APS and NFMC) (2 000 shares x (600 000 lei / 5 000 shares))	240 000	314	311
3.	Accounting note	Recording the difference between the sale price and the nominal value of the shares placed in the additional issue (2 000 shares x (121 lei - 600 000 lei / 5 000 shares))	2 000	314	317

Hence, as stated above, it can be ascertained that acknowledging capital premiums corresponds to the callable capital at the establishment/foundation of the entity, and it corresponds with unregistered capital at the increase of the share capital.

*Next, there will be presented the situation of the surplus between the nominal or the alienation value and the withdrawal value of the own repurchased shares that are subsequently canceled or disposed of.* This situation of determining capital premiums is characterized by 2 types of economic transactions, namely:

- ✓ upon the cancellation of the redeemed shares, which determines the decrease of the share capital. Upon the cancellation of the redeemed shares, capital premiums can be registered *only* in the situation when surplus is obtained between the nominal value and the withdrawal value of the repurchased shares and subsequently canceled;

- ✓ upon the alienation of the previously redeemed shares. Upon the alienation of the previously redeemed shares, capital premiums can be recorded *only* when there is a surplus obtained between the alienation value and the withdrawal value of own repurchased shares that are subsequently disposed of.

The accounting entry for the sum of which the nominal value or the alienation value surpasses the withdrawal value of own redeemed shares that are subsequently canceled or alienated is the following:

*Debit account 315 "Withdrawn capital"*

*Credit account 317 "Capital premiums"*

Instance of ransom and cancellation/resale of shares: Entity "Z" stock-joint company has a capital of 20 000 shares with a nominal value of 110 lei per share (shareholders are legal persons). On July 15, in order to prevent the decrease of the share price, 20 000 own shares were redeemed at the price of 102 lei per share.

On August 15, when the General Meeting of Shareholders was convened, it was decided on annulling 1 000 redeemed shares. The cancellation of the shares was registered at the National Financial Market Commission, and the decrease of the share capital passed the state registration to the Agency for Public Services.

On September 20, 1 000 actions were resold to the price of 115 lei per action. [10, 11].

Table 3

### The record book for economic operations

Nº	Economic operation content	Sum, lei	Accounts correspondence	
			Debit	Credit
1.	Registration of the ransom value of own shares from shareholders (2 000 shares x 102 lei)	204 000	315	242
2.	Registration of the cancellation of 1 000 shares after the state registration of the decrease of the share capital (1 000 shares x 110 lei)	110 000	311	315
3.	Registration of the difference between of ransom value and nominal value of cancelled shares (1 000 shares x (110-102) lei)	8 000	315	317
4.	Registration of the resale value of 1 000 shares on September 20 (1 000 shares x 115 lei)	115 000	242	315
5.	Registration of the difference (as surplus) between ransom value and resale value of shares (1 000 shares x (115-102) lei)	13 000	315	317

In case of registration of an unfavorable difference between the nominal or the alienation value and the withdrawal value of the own repurchased shares that are subsequently canceled or disposed of, it is settled at the undistributed profits (uncovered loss) of previous years (Dt 332 Ct 315).

*The situation of the surplus between the nominal value of the bonds and the nominal value of the shares to which they have been converted will be stated below.* Thus, the present situation can be met only within the entities with the organizational-legal form of a joint-stock company. According to the provisions of the Law on the Capital Market, uncovered bonds may be issued if they provide the right to be converted into shares (art. 8, par. 2) [12]. The conversion of the company's placed securities has the effect of being excluded from circulation by the company and the cancellation of all securities of one class by their

exchange for securities of another class from the same company (if this action is stipulated in the decision on the issue of the respective securities) or against securities from another company (in case of reorganization by absorption of the respective company). The conversion of the company's securities is carried out in accordance with the requirements of capital market legislation and with the decision to issue the securities to be converted (art. 79 par. 1 of Law on joint-stock companies) [1]. In order to register the changes related to the conversion of securities in the Register of securities issuer, the company is obliged to present the following documents to the National Financial Market Commission: a) application for registration of changes; b) the minutes of the general meeting of shareholders, with all the annexes; c) list of shareholders before and after conversion; d) the last financial situations; e) copy of the payment order regarding the payment of the tax in the amount established by the Law on the National Commission of the Financial Market.

If the conversion of securities is accompanied by a change in share capital and/or by changing the number of securities placed by a certain class, the issuer will also present the documents related to the change of the share capital and/or of the numbers of securities placed. The decision on the issue of bonds convertible into shares will be publicly disclosed in accordance with art. 41 par. 5 of Law on joint-stock companies [1].

Therefore, it can be mentioned that the procedure for converting bonds into shares is strictly regulated by the legislation in force both on the way of carrying out and the way of registration of the results.

Further will be presented the accounting entries related to the conversion of bonds into shares:

- ✓ On the basis of the decision to convert the bonds into shares and the decision to change the share capital:

*Debit account 412 "Long-term loans" or account 512 "Short-term loans"*

*Credit account 314 "Unregistered capital"*

- ✓ Based on the decision of the Agency for Public Services regarding the registration of the change of the share capital and the decision of the National Commission of the Financial Market on the registration of changes in the conversion of securities:

*Debit account 314 "Unregistered capital"*

*Credit account 311 "Share capital"*

- ✓ The surplus (favorable differences) between the nominal value of the bonds and the nominal value of shares in which they were converted are recorded in the accounting formula:

*Debit account 314 "Unregistered capital"*

*Credit account 317 "Capital premiums"*

Hereafter, the situations of capital premiums' occurrence are systematized in figure 1 with the related accounting records.

The situations of appearance and recognition of capital premiums were examined above, and further the focus will be on the examination of the accounting entries for capital premiums' usage and derecognition.

According to the provisions of National Accounting Standard "Equity and liabilities" [4], it is based on the decision of the management body of the entity, that the capital premiums are settled at retained earnings (uncovered loss), the following accounting entry being drawn up:

*Debit account 317 "Capital premiums"*

*Credit account 332 "Retained earnings (uncovered loss) of previous years"*



<b>The recognition of capital premiums (Credit account 317 “Capital premiums”), the surplus (favorable differences) between:</b>				
<i>effective value and nominal value of the shares deposited in the share capital</i>		<i>nominal or alienation value and the withdrawn value of the own repurchased shares and subsequently canceled or alienated</i>		<i>nominal value of the bonds and nominal value of the shares in which they were converted</i>
<i>at the incorporation of an entity</i>	<i>at the increase in the share capital of the entity</i>	<i>upon the cancellation of the redeemed shares, which determines the decrease of the share capital</i>	<i>upon the alienation of the previously redeemed shares</i>	
<b>Debit account 313 “Callable capital”</b>	<b>Debit account 314 “Callable capital”</b>	<b>Debit account 315 “Withdrawn capital”</b>		<b>Debit account 314 “Callable account”</b>

**Figure 1.** Accounting treatment of the recognition of capital premiums.

*Sources: elaborated by the authors based on national accounting regulations.*

Although the provisions in National Accounting Standard “Equity and liabilities” [4] establish only one situation of usage/settlement of capital premiums in the national legislation, there is another situation that is not examined by the accounting standard. According to the provisions of Law on stock-joint companies’ art. 38 par. 4, the exceeding the value of the contributions made and their nominal value, *it can only be used to increase the share capital*, in this case the accounting formula is drawn up:

*Debit account 317 “Capital premiums”*

*Credit account 311 “Share capital”*

The financial reporting of capital premiums is carried out in the balance sheet and the Statement of changes in equity: at the reporting date the credit balance of the account 317 “Capital premiums” is included in chapter II, row 500 “Capital premiums” of compartment C “Equity” of *Balance sheet* or in row 130 “Capital premiums” from *Balance sheet shortened* [13-16], depending on how the entity reports. It is worth mentioning the importance of this patrimonial element by the fact that it is reported in a separate compartment II Capital Premiums, being formed by only one element. On another hand, the entities that perform complete financial reporting based on National Accounting Standards include information on capital premiums in row 70 “Capital premiums” from *The situations of changes in equity*, both the amount existing at the beginning and at the end of the period but also the changes of increase and decrease registered during the period [13-17].

#### **4. Conclusions**

As it was explained in the current research, accounting is a field regulated by increasingly complex standards, but also continuously adjusted to the rigors of time. This means that, in order to organize the accounting of some transactions/economic facts and patrimonial elements, more and more advanced concepts must be mastered. At the same time, the study identified the existence of 2 terms in the regulation of the Republic of Moldova, namely: in accounting regulations - capital premiums, in the Law on joint-stock companies - additional capital, which can lead to confusion both in the recognition and in

examination of the financial indicator for economic decision-making. The authors presented the algorithm of accounting entries related to capital premiums for each situation in their recognition, but also within the use, highlighting the connection with the transactions related to the share capital of the entity. Even though capital premiums are generated by the transactions related to the share capital, the correspondence of the accounting account of capital premiums (317) is made with the accounting account related to the unpaid capital (313) at the establishment of the entity, with the accounting account related to the unregistered capital (314) when increasing the share capital but also when converting the bonds into shares, and also with the accounting account of withdrawn capital (315) upon cancellation or resale of the shares. Likewise, an identified divergence is the use of capital premiums established in the accounting regulations and the Law on joint-stock companies. The importance of the equity element of capital premiums is also highlighted in the financial reporting by presenting it in a separate subchapter of the balance sheet but not in the elements of share and unregistered capital that determine capital premiums

**Conflicts of Interest.** The authors declare no conflict of interest.

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