Response to reviewers comments.

Friday, 19 September 2014

Both reviewers have made a very positive contribution and reference to this is now included as a footnote to the article.

Reviewer A

An excellent article with well developed arguments and incisive thinking. I have made several suggestions for the improvement of grammar and punctuation as per a copy of the article which I shall upload and send with this review. (Apologies for the handwritten scrawl. I am sure that the author will get the gist of my notes.) The research question is clear and concise and the method adopted is appropriate for the purpose. The article is certainly suitable for publication. However, the important contributions made in regard to defining the differences between ‘Provisions’ and ‘Reserves’ and the recommendation that a new ‘Year to Close’ provision be introduced is not mentioned in the Abstract. This dilutes the impact of the study and readers may therefore not appreciate its full import.

We have now reworded the abstract to highlight more clearly the contribution of the article, including the matters suggested.

Reviewer B: REVIEW

Article: “Derivation of a framework for annual financial statements of a property-casualty insurance firm: from Adam Smith to the modern insurance firm”

I have reviewed this article and my comments are as follows:

General comments:

As a point of departure, the article uses a quote by Adam Smith, from his “An Inquiry into the Nature and Causes of the Wealth of Nations” (1776), in which Smith captures the essence of an insurance enterprise in a very simple way. It then proceeds to develop a structure for financial accounting for insurers from that base. This is an interesting approach, as it demonstrates that the basic components of the insurance transaction remains relatively unchanged to this day in the financial management and reporting for insurance enterprises.

Abstract:

The abstract appears succinct and relevant.

The abstract has now been expanded upon as suggested by Reviewer A.

Body:

There is certainly a theme running though the manuscript, but it falters somewhat in the latter part, when the author seems to need to compress a lot of detail into the available space. The Reviewer’s observation is correct and arises from space contraints. When first submitted the view was that it was too long and had to be shortened which was done. The process linking the framework to Adam Smith’s statement is more pronounced in the beginning with the understanding that the academic reader will understand the same process is applied in the rest of the article but not articulated in the same detail. It is for this reason spreadsheets instead of equations are resorted to.

We may add the article has been prescribed for honours students in this country and masters students in England and has proven to be very useful in understanding the operation of insurance companies. The balance is about right.

I am also not sure that the link between the ultra simple premise of Smith’s statement to the modern insurance firm is adequately developed.

Again this could have been explained in greater detail but not within the space constraints. The important academic goal is achieved; starting from first principles to develop a final complex outcome. This has been validated by giving honours students practical problems and against the background of the article allow them to suggest solutions. The article does indeed provide the answers. Having done this a CEO of an insurance company was invited to provide his insight to the problems and his insight was consistent with that derived from the article. We are satisfied on this point using students in South Africa and England that the article is useful.

Also, the mention that Smith makes of capital is misconstrued to some extent. Smith appears to refer to capital only in a context to justify a fair profit from the business of insurance – he sees it as equivalent to any other trade that the investor may choose to fund. He may be implying that there is some capital to be invested, but does not develop the need for capital as a guarantee against losses in the insured portfolio beyond the premiums collected and the expenses of doing business being paid.

We agree with the Reviewer. The portion in the article dealing with capital has been rewritten and watered down considerably. It original formulation was not necessary to achieve the purpose. Simply Adam Smith’s treatment of capital raised questions which required some discussion. In view of the current debate sparked by Thomas Piketty we are more than happy to avoid the debate in this article! That can be left for another day, a different kind of article.

I have noted where I believe the expression of relationships between the various components of the financial statements needs to be stated by equations, especially in the latter half.

The application of the theory to the statements of an actual insurer is useful and instructive.

The article has been substantially rewritten to take these issues into consideration, within the space constraints of the journal. All endnotes except the one thanking the referees have been removed. The space constraints preclude using more equations as these have now been incorporated into the spreadsheets as now explained in the article itself.

Originality:

There is a dearth of published material on the nature and structure of accounting for Property-Casualty insurance enterprises. This work develops a model for the accounting in an interesting manner, and that would be a useful contribution to the field. The reader should note that the position in modern insurance enterprises are much more complicated than the position that Adam Smith described more than two hundred years ago. The premise that Adam Smith may have provided a basis for more extended formulation of financial statements in insurance enterprises must be seen as only that – the development of the accounting science for insurance has progressed far beyond Smith’s time.

The view of the Reviewer is correct. But the principles setout by Adam Smith remain fundamentally correct and are unaltered. It is the application of these result in the details of the modern financial statements being derivable from Adam Smith’s statement.

Relationship to literature:

Although the initial part of the article is based fairly well in the literature, I would suggest that some of the statements in the manuscript could do with more substantiation from the literature – especially toward the end of the manuscript. The issue of solvency and the recording and valuation of assets is a hot topic in the current insurance regulatory environment and I would have liked to see that being explored some more.

**The Reviewer is correct. The intention is that this article set out the framework and further articles expand on the framework and discuss in greater detail the issues raised. Space will not permit these to be raised at this point and it is no the custom to raise too many issues in a single article. The custom is to deal with different matters in additional articles.**

Research methodology:

The bulk of the manuscript is based on a literature search that appears to be relevant and applicable to the subject matter. The deduced framework is also then successfully reflected in the financial statements of an actual insurer. This empirical application of the theory is well executed and helps the reader to follow the theme.

Results:

As commented above, the application of the theory to the actual set of financial statements is well done. My own cross-checking revealed no discrepancies that I could find.

Recommendation:

I have marked up the manuscript at various points with comments and suggestions. Even though this was not my purpose, I have also made minor changes to punctuation and some wording changes. There may still be more editorial work to be done before the manuscript may be published.

My main suggestion is that the relationship between the quote by Smith and the development of the model for the structure of the financial statements of an insurance enterprise should be strengthened. I am looking for some sort of bridge between the past (Smith) and the present. This may be achieved with some elucidation of the need for accounting (in the broader sense) for the particular features of the modern insurer (temporal allocation, provisioning, accrual of earnings and such) before diving into the detail of the various components.

The author is advised to extend the manuscript as suggested and then it should be fit for publication.

The manuscript has essentially been re-written to take these comments into consideration