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Index Auditing Model in Sweden

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Index Auditing Model

Background
Our aim is to capture a representative, average, pure price movement (adjusted for volume and quality changes) for all product groups (or industries) and weighted to the total for the entire economy in each measurement period. A current gap in general price index theory and practise is quantifying in a meaningful way how well we are meeting this goal (or the risk that we are not). This model has a general purpose to provide an answer to this challenge with a focus on the quality of individual indexes. A score is generated based on a number of criteria applied to a x-digit level index. Results are then reviewed both at the individual index level and at the aggregate level.

Purpose
Primary:

- Understand where index reviews are likely needed (evidence based)
- Provide a transparent consistent basis for resource allocation / planning
- Give input to our internal users' own auditing (for example, National Accounts)

 Secondary:

- Increase the understanding of price indices (and their quality) amongst users
- Increase our own understanding of the types of process data that are able to be collected and analysed
- Encourage discussion about important end-to-end aspects of index production and output

Categories
 1. Sampling/Coverage
 2. Pricing Methods
 3. Specifications
 4. Response Data
 5. Quality Adjustments

Valuation Grade
 1 = Low quality / high risk; the index likely has a clear bias, index review required
 2 = Low-medium quality / medium risk; index should be representative in the long term but may be misleading in some periods; index review required
 3 = Ok, approved (not prioritised for immediate review)
 4 = Good quality / low risk. High confidence in the representativeness of this index; not a review priority
 5 = Excellent quality / low risk. Not a review priority

The aim of the model is to use as much quantitative information as possible. This is to maximise transparency, repeatability and comparability of the audit. Out of necessity some categories include both subjective and quantitative valuation methods. Valuations should be motivated with descriptive justifications.

Output
 Index review at the x-digit level of aggregation with detailed assessment (2-digit level in Sweden)
 Audit summary enabling assessment of all index results (results by index / results by criteria)
 Visualisation / compilation that enables comparison of different assessment periods to review progress

1. Sampling/Coverage

Valuation Criteria	Description of current status	Reference Data	Guidance	Grading Motivation	Grade
Sampling Method	PPI General - PPS		Does the selection method allow all objects in the population to be drawn? Is there a risk that we will miss a significant part of the price trend otherwise? Is it possible to calculate		5
Sampling Frequency	PPI General - Annually		The higher the sampling frequency the higher the likelihood that the index is representative of actual market activity which results in a higher rating.		5
Sample Frame's Timeliness	PPI General - Frame is two years old (y-2) SPPi General - Frame is three years old (y-3)		The older the frame is that greater the risk that the frame isn't representative of reality. An older frame is equivalent to a low rating.		4
Attrition	Process data from annual update work (code 7).		A high attrition rate at the sample selection process leads to uncertainty that we are measuring accurately what we want to be measuring. A high attrition rate equates to a low rating.		3
Coverage	Proportion of total production being directly covered.		The higher the coverage the higher certainty we have that we accurately represent market activity. A higher coverage equates to a high rating.		3
Random sampling error	Variance/ standard deviation calculated from process data from annual update work.		Higher variance is equivalent to higher uncertainty and is considered as a risk giving a lower result.		3
Cut-off	Proportion of the population outside of the cut-off		The higher the proportion of the population that is outside the cut-off the lower the certainty we have that we accurately represent market activity.		3
Frame error	Process data from annual update work (code 8.9 and 8X).		A high percentage frame error results in higher uncertainty and a lower rating.		3
	<How reliable do we estimate that the development of the index has been using the above guidance?>		Comments	<comments included here will be included in the summary reports>	
Valuation Grade					3.63

5. Quality Adjustments

Valuation Criteria	Description of current status	Reference Data	Guidance	Grading Motivation	Grade
Proportion of specifications updated (product change / product update)		Proportion of specifications updated	Updating specifications is important to maintain representativeness. However, changes can add subjectivity to price measurements. A high % of changes is considered a potential risk.		3
Quality Adjustment Method	1. % - implicit 2. % - explicit	1. % - implicit 2. % - explicit	Ideally quality adjustments are well informed. This criteria sheds light on the prevalence of implicit and explicit methods. A high % of for example carry forward adjustments is deemed a risk.		4
Weighted effect of quality change		Proportion of index develop for X reporting periods that is attributable to quality change.	An overly large influence from quality change or no prevalence of quality change at all are both indicators that		2
Quality adjustment method (1)**					
Quality adjustment method (2)**					
Quality adjustment method (3)**					
Quality adjustment method (4)**					
Quality adjustment method (5)**					
	<How reliable do we estimate that the development of the index has been using the above guidance?>		Comments	<comments included here will be included in the summary reports>	
Valuation Grade					3.00

2. Pricing Methods

Valuation Criteria	Description of current status	Reference Data	Guidance	Grading Motivation	Grade
Actual prices - "direct use of prices of repeated products" (excluding contract prices)		Proportion actual prices.	A high percentage equates to a high grade. That is, a high usage of actual transaction prices of repeated products equates to a low risk.		5
Contract Prices		Proportion contract prices.	3-6 contracts with varying renewal periods (per reporting provider) are required for high ratings. A low number of contracts with non-varied renewals results in a low rating.		3
Transfer prices		Proportion transfer prices.	The rating is user dependent. For NA, the use of transfer prices is approved. On the other hand, if it is for contractual regulation, it is not approved.		3
Estimated prices using related observed prices (Component and/or percentage fee prices)		Proportion related observed prices.	High percentage of estimated prices as well as specifications that are not regularly updated give low ratings. Quality issues with underlying index also give a low rating.		3
Hypothetical prices (Model prices)		Proportion model prices.	High percentage of model prices and models that are not regularly updated gives a low rating.		3
List prices		Proportion list prices.	A high percentage of list prices results in a low rating.		3
Time based prices		Proportion time based prices.	A high percentage of time based prices results in a low rating.		4
Unit Value prices		Proportion unit value based prices.	An average price is harmful if the products included are not sufficiently homogeneous.		3
	<How reliable do we estimate that the development of the index has been using the above guidance?>		Comments	<comments included here will be included in the summary reports>	
Valuation Grade					3.38

4. Response Data

Valuation Criteria	Description of current status	Reference Data	Guidance	Grading Motivation	Grade
Imputation Methods	PPI General - default method is imputation of an average movement from the closest aggregate with more than three reported specifications. Manual imputation is also utilised.				5
Inliers. No price change.		% of specifications that have reported no price change for X number of periods (code 11)	Inliers refers to specifications that have lately showed no price change over time. A high level of no price changes is an indicator of possible error.		4
Unobserved data and non-response		1. % - 55 (no transaction) 2. % - 56 (non-response) 3. % - 57 (discontinued) 4. Total % - 55,56,57.	A large amount of unobserved data leads to uncertainty and potential bias. A high percentage results in a lower rating.		5
	<How reliable do we estimate that the development of the index has been using the above guidance?>		Comments	<comments included here will be included in the summary reports>	
Valuation Grade					4.67

3. Specifications

Valuation Criteria	Description of current status	Reference Data	Guidance	Grading Motivation	Grade
How often can specification updates be actioned	PPI General: We have full flexibility to update change specifications from month to month. A restriction is the possibility to increase the number of specifications from a particular business between annual updates.				4
Are specifications too broadly defined? (i.e. risk of product mix / undetected quality change)		1. Price volatility calculation 2. Quality check of specifications (manual check)	Specifications that are too broadly defined are regarded as not having sufficient detail to be able to adequately observe quality and may result in false price changes impacting results.		4
Are specifications too tightly defined? (i.e. low transaction frequency / high product change frequency)		1. % - product change (21.0r) 2. % - non reporting / no transaction (56.0r)	Specifications that are too tightly defined may have overly detailed parameters that make it difficult for companies to find comparable transactions leading to a higher frequency of product changes, non reporting and/or absence of transactions.		4
	<How reliable do we estimate that the development of the index has been using the above guidance?>		Comments	<comments included here will be included in the summary reports>	
Valuation Grade					4.00

