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**MANAGING A ROAD FUND**

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## **1. Basic Characteristics of a Road Fund**

Road funds come in all shapes and sizes. The objectives of these road funds is nearly always to: (i) provide a regular flow of funds to support spending on roads (often confined to maintenance), (ii) keep the revenues apart from the government's consolidated account, and (iii) account for use of the funds. Some road funds only finance national or main roads (South Africa), some only finance state, provincial and regional roads (Argentina, the state road and transportation funds in the USA, the Russian regional road funds, and the regional municipal road funds in Latvia), and some have been set up as urban road funds to only finance urban roads. Most, however, finance expenditures on the whole road network.

Some road funds also finance non-road expenditures. The Korean "traffic facility special account" (the expanded 1994 version of the 1989 road sector special account), includes a special account for urban rail, express rail, airports and harbors, while the US Federal Highway Trust Fund finances community road safety programs, high speed rail lines, bike trails and makes transfers into a mass transit fund. The Latvian State road fund finances passenger bus subsidies, while the New Zealand road fund finances passenger transport, the Land Transport Safety Authority and Police road safety enforcement, before the balance is transferred to Transfund. Furthermore, although Transfund primarily finances roads, since 1996 it has also started to finance local authority "alternatives to roading".

## **2. Arrangements for Managing the Road Fund**

There are several possible ways of managing the road fund. When one road agency is responsible for managing the entire road network, the road fund can be managed by the same agency managing the road network without creating any conflict of interest. Otherwise, there should be a separate road fund administration to channel funds in an even-handed way down to the various road agencies entitled to draw from the fund. This is now the case in Ghana, Lesotho, New Zealand, Malawi and Zambia. The agency does not need many staff, since it normally collates the programs of the various road agencies, reviews and consolidates them into the approved national road program, defines the financial procedures to be followed by the agencies receiving money from the road fund, allocates funds to support the approved programs, disburses funds to the road agencies and then audits the results *ex post*. It may also audit the systems and procedures used by each road agency (to prepare the road program and control expenditures) – as in New Zealand and USA – and will also manage the day-to-day affairs of the road fund. Based on the figures for the Latvian, New Zealand, Russian and South African road funds, it should not take more than about five staff to manage an annual turnover of about \$100 million and 30 to 35 staff to manage an annual turnover of about \$500 million.

## **3. What Should the Road Fund Finance?**

The TOR for the road fund has to state clearly which items the road fund can finance and should give some indication of priority. Maintenance is usually made the *first charge* on the road fund. The costs of administration (often with a cap) and selected road

safety projects usually come as the second charge on the fund after all road maintenance expenses have been met. Quite a few road funds also provide money for road rehabilitation—particularly the counterpart funding of donor-financed rehabilitation projects—and funding for minor upgrading and improvements (again, often subject to a cap). For example, the regulations might say something like, “The Road Fund shall be used primarily to finance routine and periodic maintenance, which shall remain as the first charge on the Road Fund. The Road Fund will also meet the costs of administering the Road Fund. Once all road maintenance requirements have been met, the remaining funds shall be used exclusively to finance selected road safety projects, road rehabilitation (not to exceed 20 percent of annual revenues), minor improvements and new works (both together not to exceed 15 percent of annual revenues).”

Investment is a more difficult topic. Some road funds—like those in Japan, Latvia, New Zealand, South Africa and USA—also finance investment (the Federal Highway Trust Fund was initially set up to finance only investment in the inter-state highway network). Most others concentrate on maintenance. The concern is that a fund which finances both maintenance and investment may give undue attention to new roads at the expense of maintenance. It is also the case that major new roads tend to have major land-use impacts and many people consider that these decisions should be taken at cabinet level. Many countries therefore have a preference for a road fund regulation which says that, “Major new works will continue to be financed through the government’s development budget.” However, in the long-term, the road sector will probably have to become financially independent and the road fund will then have to finance *all* road expenditures.

#### **4. Source of Funds**

The only source of revenues should be the charges making up a two- or three-part road tariff. Keep the tariff as simple as possible and try to avoid referring to the charges as “taxes.” Also make sure that the revenues do not include any earmarked general taxes (import duties, sales and excise taxes). The tariff will generally consist of:

- (i) a road maintenance levy added to the price of transport fuels;
- (ii) vehicle license fees plus, where feasible, a heavy vehicle license fee to ensure that heavy vehicles pay in full for the damage they do to the road pavement;
- (iii) international transit fees paid by vehicles registered in neighboring countries; and
- (iv) fines for overloading, or that part of the fine which represents the damage done to the road pavement.

Bridge and ferry tolls may also be included. Do not include vehicle registration fees, vehicle inspection fees, driving license fees, etc. These are service fees. They are not charges for use of the road network.

#### **5. Road Tariff Levels**

When possible, the road maintenance levy should be added to all pre-existing taxes. The levy should be specified as a discrete amount (that is, so many cents per liter), or as a percentage of the ex-refinery or wholesale price of fuel (or equivalent). It should

not be specified as a proportion of fuel taxes or other general revenue taxes, since this would turn it into an earmarked tax.

When first introduced, the charges must be set to ensure that they do not abstract revenues from other sectors of the economy. In other words, if the consolidated fund can afford to finance only 20 percent of maintenance requirements, then only that 20 percent should be converted into the initial license fees and fuel levy transferred to the road fund. All additional revenues must come from extra payments made by road users. Transport operators are generally more than willing to pay for more road maintenance (provided the money is spent on the roads, the work is done efficiently and they have some say in how priorities are set), since they know that \$1.00 spent on maintenance reduces VOCs by between \$2.00 to \$3.00. The MOF will generally also support any arrangements which: (i) do not lower the revenues available for other sectors; (ii) strengthens financial discipline and increases value-for-money; and (iii) leads to better road maintenance.

## **6. Collecting the Tariff**

When the road fund is set up under the Finance Act, the road tariff will be collected under the government's tax making powers (i.e., the road user charges are treated as if they were taxes) and the proceeds must usually be paid into the consolidated fund and then transferred to the road fund.. However, if the ministry of finance agrees, the funds can be deposited into the consolidated fund as a paper transaction, while the actual cash can be deposited directly into the road fund. Likewise, when the road fund is set up under a decree, the revenues may have to be deposited into the consolidated fund, though some decrees provide for direct deposit into the road fund. Direct deposit should be used whenever possible.

When the road fund is set up under new legislation, the act should be drafted to permit the proceeds from the road tariff to be deposited directly into the road fund. The act should also permit the tariff to be collected under contract (even when collected by a government department) and, when feasible, to be collected under competitively awarded contracts.

## **7. Adjusting the Tariff**

There should be a formal mechanism for adjusting the road tariff—both upward and downward—to ensure that the road fund generates sufficient revenues to meet approved expenditure requirements but does not generate excessive revenues. The oversight board should have the power to set the road tariff (in the same way that the railways set their tariffs), or to at least recommend tariff levels to the ministry of finance for inclusion in the annual budget statement. Malawi and Namibia are the only countries that have set up public utility-style road financing mechanisms, although New Zealand expects to be operating as a road public utility within about two years and several other countries are considering public utility style road fund legislation.

Most countries still set their charges under the government's tax-making powers. Under this arrangement, the board (or the responsible ministry when there is no board) recommends the revised charges to the minister of finance or the cabinet, and, once

approved, these charges are included in the annual budget statement. The ministry of finance or the cabinet are more likely to accept the recommended charges automatically if they are submitted by a representative board.

Under the public utility arrangement the road fund board sets the level of the road tariff. In doing so, it has to balance road users' willingness to pay against the revenues needed to finance the approved road expenditure program. Once it has made up its mind, the board submits its recommendation to the minister of works or transport and, provided that the minister is satisfied that their proposals are reasonable and consistent with the government's overall fiscal targets, the revised tariff becomes effective and is published in the government gazette.

When the road fund is first set up, the tariff will usually have to be raised gradually over a period of three to five years. This slow build-up enables the board to show results to its constituents before asking for further increases in the road tariff. Many boards operate extensive outreach programs to demonstrate to their constituents that they are getting value-for-money from the road tariff. Several boards also publish their accounts in the press and plant road signs stating that the road works are being financed by the national roads board. All road fund boards should consider operating similar outreach programs. Finally, while the road fund is building up its revenue base, the balance of required revenues generally have to come from donors or the general budget.

## **8. Secretariat**

It is essential to have a strong, independent secretariat to manage the day-to-day affairs of the road fund. A staff of 3 to 5 persons (perhaps 25-30 for a very large fund) is usually enough to manage the road fund and they need to have skills in accounting, administration, planning and engineering (this assumes that certification of work is done by consultants). The Executive Secretary (or Director) should be appointed by the board to ensure his/her independence and to ensure that they work effectively with the board. The Executive Secretary then appoints all other staff on terms and conditions approved by the board.

Another option is to appoint a local firm of accountants, or a local bank, to act as secretariat to the road fund. Bids can be invited, evaluated, and a suitable firm can be selected. They need to have a clear TOR and a clear contract. A sample letter inviting local accounting firms/banks to submit bids to act as Secretariat for the Road Fund, is included in Annex 8.

## **9. Daily Cash Management**

Day-to-day management of funds involves making projections for revenues, commitments, and disbursements. Based on cash-flow projections, the board will have to decide how to handle short-term borrowing and what to do with any cash surpluses. Since the road fund should maintain only a small cash surplus, the funds should be invested in short-term securities like interest-bearing savings accounts and the overnight money market.

Procedures for withdrawing funds should be made as simple as possible. It is usually sufficient to have each check drawn on the road fund signed by one member of the board and the road fund's senior accountant. There should be alternates in case one of the nominated signatories is unavailable. Road fund staff must also oversee the use of funds by each road agency. This involves specifying how investment and maintenance programs are to be prepared, advising road agencies on how to prepare their road programs, and auditing the results to ensure that the procedures laid down by the board have been correctly applied.

Finally, there is the important job of preventing unauthorized withdrawals. Unfortunately, this is a constant preoccupation for many road funds in countries where governance is weak and ministers and senior civil servants frequently attempt to use money from the road fund to finance other government programs or to otherwise promote their own private interests. Some road funds have developed ingenious ways of discouraging raids. However, the best strategy—apart from having a strong board—is to keep a minimum cash balance in the road fund account. Work should be programmed—and charges adjusted—to ensure that revenues and expenditures are closely matched, avoiding the need to hold a large cash balance.

## **10. Audit Arrangements**

Once road maintenance is fully funded, the road fund will be handling large sums of money and it is important to ensure that these funds are properly accounted for. That is the purpose of the audit. The audit should normally include: (i) examining the records of third parties responsible for collecting the revenues attributable to the road fund to ensure that all the revenues have been collected and promptly paid into the correct road fund accounts; (ii) auditing payments made from the road fund to ensure they are supported by adequate documentation and are in accordance with the purposes allowed in the legislation and supporting legal regulations; (iii) verifying that the work financed from the road fund was carried out according to specifications; (iv) auditing the transactions and balances of the bank accounts maintained by the road fund; (v) reviewing the accounting and internal control procedures used by the road fund to determine their adequacy; and (vi) reviewing the accounts, files, records, and reports of the road fund to determine their adequacy.

The audit report is normally submitted to the minister of the parent ministry no later than three months after the end of each financial year. The minister then submits the report to parliament. The auditors' report may also be included in the road fund's annual report. The accounts may be audited by independent auditors appointed by the board, by the auditor general's office, or by an independent firm of auditors selected by the auditor general. The audits carried out by the auditor general's office are surprisingly thorough, although this varies by country. Audits by independent auditors can be more variable. The qualifications and integrity of the auditors needs to be closely monitored.