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OPEN LETTER TO MR DE FREITAS, DA MEMBER OF PARLIAMENT, FROM THE GROUP CEO OF PRASA, LUCKY MONTANA, ON THE FINANCIAL POSITION OF METRORAIL

Dear Hon. De Freitas

The Passenger Rail Agency of South Africa (PRASA), the parent company to Metrorail, has taken note of your statement, alleging “Metrorail can’t pay its bills yet wastes more money”. It is unfortunate and regrettable that the statement is based on a “leak to the DA” which raises serious questions on the agenda behind those behind the leak. It is our belief that Honourable Members of Parliament have access to information from the relevant Executive Authority and/or directly from the affected public entity. PRASA, like other public entities in terms of the Public Finance Management Act (PFMA), submits quarterly reports to Government, and tables to Parliament at the end of any financial year its financial statements, confirming its financial position and performance against agreed targets. PRASA, formerly the SARCC, has since the 2006/07 financial year received unqualified audit reports from the Office of the Auditor-General.

It is important that discussion on the financial position of PRASA is grounded on factual information and proper analysis of its financial statements. If it is to inform public debate and ensure public accountability, discussion cannot be based on deliberate and selective leaks of information.

What are the facts about PRASA’s Financial Position:

1. PRASA embarked on a cost-containment strategy since July 2009. This was aimed at reducing operational costs, introducing operational efficiencies and cutting down on wasteful expenditure. Cost-Containment measures were introduced following the difficult operating conditions of the 2008/09 Financial Year, where prices of material especially copper and steel, labour and energy increased beyond available resources. PRASA delivered on its key targets, such as the consolidation of passenger entities into PRASA, delivery of 709 refurbished coaches above the set target of 700 and other infrastructure investments, which increased the



value of assets by over R2.4 billion. PRASA increased passenger trips by 9.2% year on year, exceeding the target of 627.3 million passenger trips and achieving 646.15 million passenger trips, increased Metro Plus Passenger Trips, including Business Express Trips by 24%, exceeding the target of 6% by 18% (Metro Plus passenger trips increased from 28.9% million to 35.8 million trips), increased fare revenue exceeding the target of 7% by R83.73 million and attaining a 12.1% increase to R144.71 million, and reduced crime by 40% on the trains. PRASA has done well to deliver infrastructure such as the upgrading of key stadia in preparation for the 2010 FIFA World Cup™.

2. These are important achievements for a business which 3 - 4 years ago was in serious trouble and whose ageing fleet and infrastructure, obsolete technology as well as archaic operations were defined as being on a “knife-edge”. Commuter rail services were unable to meet passenger and customer demands and were on the verge of collapse.
3. However, delivery on these important milestones came at a huge cost to the business due to huge increases in the price of energy, material, steel, copper and labour. PRASA managed to finance most of the deficits from the huge reserves that we had built over the years. The most immediate challenge for PRASA is to re-build its reserves so that we do not erode further value and weaken the balance sheet of the company. These facts and trends are recorded in the 2008/09 financial statements and captured in the Annual Report of PRASA tabled in Parliament last September 2009, which Mr De Freitas, MP, received as a Member of Parliament.
4. Contrary to the false assertions about ‘Metrorail wasting more money’ contained in documents “leaked to the DA”, the root causes of the financial challenges facing PRASA are as follows:
 - Increases of 25% and 32% in electricity prices during the 2008/09 and 2009/10 financial years respectively. The 32% increase in the current financial year will cost Metrorail an additional R120 million to R340 million against a budget of R248 million. The 07/08 forecast for 2010 shows that traction energy for Metrorail was expected to be in the order of R220 million but had increased so enormously, with the huge increase not budgeted for by PRASA nor provided for by Government. A submission for funding of the increase in the price of traction energy has unfortunately not yielded positive results.
 - For over five (5) years, no approval was granted for Metrorail to increase fares. This simply means that Metrorail services have become un-economical. Whilst PRASA

and the Department of Transport are committed to the policy goal of affordable transport for all, failure to increase or adjust fares whilst operational costs are on the rise, is irresponsible and will simply lead to the asset further being run down.

- The liabilities (pension, medical, staff leave, loans, etc) associated with the consolidation of Metrorail, Shosholoza Meyl and Autopax into PRASA remain largely unfunded.
- The Due-Diligence Report on Shosholoza Meyl showed that PRASA would require about R1.4 billion per annum to run the business. However, only R450million per annum is provided to PRASA to run this service. The truth is that this business is grossly under-funded, and if not properly addressed, it will become a burden on PRASA's financial position.
- Labour costs have been on the increase resulting in personnel costs as a percentage of operating costs reaching unacceptable levels. PRASA accepts that this situation is unacceptable and has embarked on a plan and negotiations with Labour to change the costly, outdated and inefficient conditions of employment. However, this gave rise to strike action recently, with employees within Metrorail trying to defend conditions of service inherited from the past, which are no longer sustainable.
- Depreciation, as a non-cash book entry, has been one of the major items on PRASA's Income Statement which affects PRASA's bottom line. As you are aware, PRASA receives an annual operational subsidy exclusive of depreciation. However, to comply with GAAP, depreciation for infrastructure assets and rolling stock is accounted as an expense. This expense, worth over R300 million for the 2008/09 financial year is not subsidized and has an adverse effect on the shortfall every year. This accounting treatment i.e. compliance with GAAP, has created misunderstanding of our Financial performance or position. To this end, PRASA has formally taken up this matter with the Office of the Auditor-General so that the anomaly is addressed.

5. I am satisfied that as the PRASA Executive Management, we have been focused on addressing PRASA's financial position since July 2009. Among the many interventions made by Management are the following:

- A saving of R442 million on capital projects being implemented in the current financial year.
- Refusal to pay suppliers where no proper invoices or supporting documents have been provided.

- Re-negotiating payment schedules with suppliers where legitimate contracts exist and delivery to PRASA has been achieved.
 - Cutting down on travel and accommodation within the business
 - Cancelling even critical international travel within the Group
 - Reducing or cancelling trains which are empty (Metrorail) and those with less than 40% patronage for long-distance trains
 - Reducing working hours from 12 hours to 7.5 hours as a way of reducing overtime and over-expenditure (recent unprotected Metrorail strike was about resistance to this important change).
 - Engaging with the Office of the Auditor-General to find a sustainable solution on dealing with the depreciation issue in our income statement.
 - PRASA is expecting to realize major savings of over R500 million over the next 12 – 18 months on the operational side through the implementation of the following:
 - ❖ new conditions of service for employees from 1 April 2010,
 - ❖ Consolidation of Metrorail and Shosholoza Meyl into a single rail business from 1 April 2010, where we will benefit from the many synergies that exist between these two operations,
 - ❖ Implementing an Operational Efficiency Project for our rail operations starting 1 April 2010, and
 - ❖ Restructuring the retirement and medical funds to reduce the huge and unfunded liabilities arising out of the consolidation of the SARCC, Metrorail, Shosholoza Meyl, Intersite and Autopax into PRASA almost a year ago.
6. In addition to the above measures, I have taken a firm position against wasteful and unauthorised expenditure as Accounting Officer in terms of the PFMA, within the PRASA family. To this end, the Acting CEO of Shosholoza Meyl was suspended on 28 January 2010 and is facing disciplinary hearing for serious breaches of the PFMA, including unauthorized and over-expenditure. I have also asked the CEO of Metrorail to provide, within 48 hours, an explanation in writing for his failure to manage controllable costs within Metrorail, poor train service performance, especially the neglect of the Tshwane Business Express service offering and why disciplinary action should not be taken against him. Further action will follow against those managers in the engineering departments who may have exceeded their budgets for capital projects without obtaining prior approval through the Group Capital Programme Committee of PRASA. The Metrorail Regions have also been found wanting and firm action will be taken against those who exceeded their budgets. The Management team of Metrorail



in Gauteng was instructed to pay PRASA back for the wasteful expenditure on the party held in SOWETO during celebrations of Womens Day last year. If truly acting in the public interest and not other hidden agendas, I expect you, Hon Mr De Freitas, to strengthen our hand in transforming Metrorail to becoming a world-class organization capable of delivering high-quality services, and not use your Parliamentary position to fight for disgruntled individuals who are opposed to change within PRASA.

It is important for me, on behalf of PRASA, to provide a detailed explanation and details regarding the cost-drivers within this important public entity. I do so in the public interest.

I am particularly concerned that your statement is not focused on the challenges facing PRASA per se. I have noted the reference to 'ESKOM and other public entities that find themselves in a difficult financial position and issues of mismanagement'. It is clear that there is no interest on your part in the success of any of these entities, no interest in understanding, through deeper analysis of the facts surrounding each of these entities. The agenda is clearly to suggest that these entities are being mismanaged by the current black managers leading them. This is not the basis of an informed public debate and discussion about the role of State-Owned Enterprises and how they contribute to the growth and development of the South African economy. I am therefore not surprised and am not expecting this to be the last of "leaked documents to the DA" making gratuitous and unfounded allegations.

In conclusion, let me reiterate my personal commitment and PRASA's commitment to good governance and adherence to the provisions of the PFMA. There are no short cuts in this challenging task. We have been given a mandate to consolidate passenger rail entities into a single business reporting to the Minister of Transport, and to follow this with restructuring the delivery of public transport services to citizens. Among the critical changes we are introducing is to ensure that PRASA, like SAA, Denel, Land Bank, is properly capitalized and its funding model accordingly revised. The Board and Management team of PRASA have put a strategy in place to ensure that PRASA, over the next five (5) years meets its obligations to the customer and deliver on its legal mandate. This restructuring and transformation will take time, and includes the modernization of our rail technology and capitalization of its property portfolio. This requires hard work by all of us and not leaking documents that fail to understand our strategy and plan, and fail to appreciate that the current model for passenger railway inherited from our apartheid past has now reached the end of its lifespan.



I look forward to our continued engagement on these vitally important issues and challenges in the transport sector.

Kind regards

Lucky Montana
Group CEO: PRASA
Date: 7 February 2010