A Salutary Lesson
Australian Pharmaceutical Industries

An Infonomics White Paper

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API suffered the ignominy of having to suspend its shares from trading and subsequently announced an extra-ordinary reduction in profit, which was attributed to problems with a new ERP software system.

What can Directors learn from the experience?

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Note to readers

This paper was developed solely through reference to public domain information about the problems experienced by API. All of the information referenced here was published in one or more of the national press, the API Annual Report, the API web site (as media releases) or on the ASX (Australian Stock Exchange) web site. No information was sought from, or provided by Australian Pharmaceutical Industries or any of its personnel or associated organisations.

The intended purpose of this paper is to promote debate in the community, particularly among senior ranks of public and private sector organisations, regarding the need for, and apparent lack of effective corporate governance of information and communication technology. By drawing on the obvious problems that occurred at API, the paper aims to sharply focus its readers on the need to ask straight-forward questions throughout an IT investment initiative, to ensure that fundamental corporate risks are detected, managed and avoided.

Mark Toomey 4 September, 2006.

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Preamble

Would it be unreasonable to expect organisations to learn lessons from their own experience and the experience of others? Amazingly, when it comes to IT, it seems that the expectation is unreasonable, and we continue to see organisations being damaged by avoidable failures at both project and operational levels. Analysis of failures generally points to a fairly small set of basic underlying causes. One would expect that with bodies of evidence in hand, the people who control and monitor IT activities would be able to identify signs of trouble and initiate corrective action well before trouble sets in.

For many though, the reality seems to be far different. In general conversation with directors, executives and IT leaders, I get the impression that everybody agrees that IT failures are a serious issue, and that they also think that their own organisations are not at risk.

The leaders at Australian Pharmaceutical Industries appear to have not detected problems with their complex replacement of core accounting systems until it was much too late. API found itself newsworthy in a most inauspicious way in mid-July 2006, when it asked the ASX to suspend trading in its shares. The situation that developed gave us another case study from which we hope organisations of all types can learn valuable lessons.

API Reports a Problem

"Since the end of the 2006 financial year, the company has been through a trying period and the events are unacceptable for shareholders… The announcement of our full year financial result was delayed, as during final consolidation of the 30 April balance sheet, a number of significant items did not reconcile."

"It is the view of the company that the discrepancies related to the processes in the conversion from the previous legacy IT systems to the new IT platform. The unreconciled balances totalled $17.2 million."

"The review also identified improvements in the financial processes, controls and resourcing which were inadequate during the conversion process."

"From the investigation undertaken it appears that the unreconciled balances are related to the upgrade of IT systems in the Pharmacy Distribution business. API had changed from two legacy IT systems to a fully integrated ERP system. The changeover was extremely complex; and, to minimise disruption, financial transactions were maintained on all three systems as each state's operations converted separately and progressively."

The above text is extracted verbatim from the Australian Pharmaceutical Industries (API) 2006 Annual Report. These quite profound statements are presented in the Chairman's Report, which is the first chapter in the Annual Report: (www.api.net.au/investor_relations/2006_annual_report.pdf).

The problem became public knowledge on July 14 when API issued a press release announcing that it had asked the ASX to suspend trading in its shares. Included in the announcement was a specific reference to the linkage between new systems and the company's inability to release full-year accounts. A further statement, made by API on July 28th, promised a thorough investigation, with direct board oversight through a specially-formed board sub-committee.

The consequences to date

Corporate disasters are usually accompanied by top executive changes and sometimes by board departures. In this case, there have been two changes in the executive and one at board level – though none of these have been explicitly linked to the problem with statutory reporting.

Chief Executive (Group Leader in API parlance) Jeff Sher was first to exit with the details of his departure subject to a confidentiality agreement. A press release dated August 14th announced his departure and the appointment of Stephen Roche to the role.

API lodged its statutory accounts on August 21st. A press release explained the decision to report a "one-off Other Expense of $17.2 million" and the findings of the review and the steps that API is taking in response to the situation. Among other matters, it makes specific reference to developing procedures to reduce complexity and risk in certain procedures for manual journal entries.

Also on August 21st, another API press release announced that Chief Financial Officer Daniel Lucas had been asked by the board to leave with immediate effect. Mr Lucas had been with the company for less than 6 months. The press release states unequivocally that Mr Lucas' departure "is not linked to the $17.2 million one-off Other Expense that the company announced on 14 August 2006".

The same press release announced the forthcoming retirement of non-executive director Michael Smith, and his immediate resignation as Chairman of the Audit and Compliance Committee. The press release noted that Mr Smith had served the company for 25 years and his retirement plans had been previously advised to the board.

The ASX share trading suspension was lifted on August 22nd. From a closing price of $2.25 immediately prior to the suspension, API opened at $1.63, rising to a high for the day of $1.94 and closing at $1.86. More than 8.5 million shares were traded on August 22nd. Since then the share price has seen a high of $2.06 At the time of writing, the company's share price was $2.00.

The press has a field day

Did the spreadsheets play a part?

ASIC comments

What can Directors Do?

Principles for good governance of ICT

Understanding ICT Governance

Ordering Information

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