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Audits Scrutinized at Operator of Hospital-Supplies Web Site

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Hundreds of nonprofit hospitals that invested in a specialized electronic commerce company had their holdings shrink by about $44 million yesterday after the company announced that it was reviewing certain accounting methods and might have to restate its financial reports going back two years.

The company, Neoforma, said it was consulting with the Securities and Exchange Commission on the best way to account for a 2000 agreement it reached with a closely related company, Novation, a for-profit buying consortium that is owned by more than 1,000 hospitals. The hospitals own about 60 percent of Neoforma through investments held by Novation's corporate parents.

Neoforma said it was still unclear whether its books would have to be revised, and if so, by what amounts. But it said that in the worst case almost all of its revenue for the last two years would be wiped out.

If that accounting treatment is selected, Neoforma's revenue for 2001 would fall to $3.2 million from the $27.8 million it had previously reported. Other accounting treatments would be more favorable to the company.

Revenue growth is an important measure of Neoforma's performance because the company is unprofitable and has no net income to track.

Last April, The New York Times reported that some hospitals were already unhappy with Novation's decision to back Neoforma with about $70 million in subsidies, stock purchases and loans, through its two parents, VHA Inc. and University HealthSystem Consortium. Also, some executives of Novation and its parents had invested personally in Neoforma.

Novation responded to questions by issuing a written statement, saying that the accounting questions had no direct effect on the underlying strength of Neoforma's business.

"We're very pleased with Neoforma's performance," the buying group said, citing several nonfinancial indicators of the company's progress.

Neoforma, a Web site where Novation hospitals and others can buy supplies, has reported losses in excess of $500 million since it was founded in 1996.

Even before the announcement, some investors had doubted Neoforma's ability to sustain revenue growth, because most of its revenue comes from one customer, Novation.

In its annual report for 2001, Neoforma reported that 88 percent of its revenue came from Novation, which helps to buy medical supplies for a third of the nation's hospitals.

Neoforma's stock 37 percent, to $6.75 In addition, several analysts who follow the company downgraded their recommendations because of the accounting questions.

Those questions stem from a July 2000 agreement that defines how Novation and Neoforma work together. In it, Novation gave Neoforma the exclusive right to provide an online marketplace where Novation's hospitals could order supplies electronically; in exchange, Neoforma gave Novation's parents shares of stock and other securities.

On Monday, Neoforma disclosed that its auditors were also uncertain of how to properly account for that transaction.

Until now, Neoforma said, it has used an accounting treatment approved by its former outside auditor, Arthur Andersen. The company changed auditors in June, however, and its new auditor, Deloitte & Touche, began a review of its books.

During this review, Neoforma said it had decided that "given the complex nature and structure" of its relationship with the various hospital groups, it should seek guidance from the S.E.C.