

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10967 / August 24, 2021

SECURITIES EXCHANGE ACT OF 1934
Release No. 92735 / August 24, 2021

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 4244 / August 24, 2021

ADMINISTRATIVE PROCEEDING
File No. 3-20468

In the Matter of

**HEALTHCARE SERVICES
GROUP, INC., JOHN C. SHEA,
CPA, and DERYA D. WARNER,**

Respondents.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES ACT OF
1933, SECTIONS 4C AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
AND RULE 102(e) OF THE COMMISSION'S
RULES OF PRACTICE, MAKING FINDINGS,
AND IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Healthcare Services Group, Inc., pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against John C. Shea, CPA, pursuant to Section 8A of the Securities Act, Sections 4C¹ and 21C of the Exchange Act, and

¹ Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others; (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

Rule 102(e)(1)(iii) of the Commission's Rules of Practice,² and against Derya D. Warner, pursuant to Section 21C of the Exchange Act.

II.

In anticipation of the institution of these proceedings, Healthcare Services Group, Inc., John C. Shea, and Derya D. Warner (collectively "Respondents") have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds³ that:

SUMMARY

1. This matter involves the failure of Healthcare Services Group, Inc. ("HCSG") to properly accrue for or disclose loss contingencies relating to pending civil litigation in violation of generally accepted accounting principles ("GAAP"), resulting in the reporting of inflated net income and earnings per share ("EPS") in certain periods. From 2014 to 2015, HCSG was facing a series of large class- and collective-action lawsuits filed on behalf of HCSG employees in state and federal courts, alleging the company had violated state and federal wage-and-hour labor laws. HCSG agreed to seek out-of-court settlements with plaintiffs in these lawsuits, and ultimately submitted settlement agreements to the applicable courts for preliminary and final approval. However, John C. Shea ("Shea"), HCSG's then-Chief Financial Officer, did not direct the accrual for and disclosure of the loss contingencies for those settlements as required by GAAP, resulting in HCSG's misstatement of net income and EPS that did not accurately reflect the company's underlying performance in multiple quarters.

2. Had HCSG properly recorded the financial impact of the loss contingencies at the time they were probable and reasonably estimable, the company would have reported lower EPS and missed research analysts' consensus EPS estimates in many of the applicable quarters,

² Rule 102(e)(1)(iii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

³ The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

including by as little as a penny. The company also would not have been able to report multiple quarters of EPS growth, including then-record-high EPS. For the quarters when HCSG eventually accrued for the loss contingencies, the accruals contributed to the company's reporting of a net loss and loss per share, or reporting EPS that missed consensus estimates by a wide margin. Consequently, HCSG's financial statements filed with the Commission were materially misleading during these periods.

3. Also, in certain quarters, Derya D. Warner ("Warner"), HCSG's Controller, made journal entries during the closing process without adequate supporting documentation as required by HCSG's policies and procedures.

4. HCSG failed to devise and maintain sufficient internal accounting controls to prevent and detect such improper accounting and unsupported, period-end journal entries described herein, resulting in the underlying violations of the federal securities laws.

RESPONDENTS

5. HCSG is a Pennsylvania corporation with its principal place of business located in Bensalem, Pennsylvania. HCSG provides housekeeping, laundry, facility maintenance, and dietary services to healthcare facilities in the U.S. The company's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act, and is traded under the symbol "HCSG" on the NASDAQ Global Select Market. HCSG files periodic reports with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder. During the relevant period, HCSG offered and sold its common stock pursuant to a Form S-8 registration statement and amendments thereto to its employees, who purchased the stock via payroll deductions. During the relevant period, the Form S-8 registration statements incorporated by reference the company's periodic reports filed with the Commission.

6. Shea, age 50, resides in Wynnewood, Pennsylvania, and is a certified public accountant ("CPA") licensed in the Commonwealth of Pennsylvania. Shea was HCSG's Chief Financial Officer during the relevant period. As HCSG's CFO, Shea was responsible for, among other things, reviewing and approving all accounting entries.

7. Warner, age 52, resides in Langhorne, Pennsylvania. During the relevant period, Warner was the Controller of HCSG. As Controller, Warner was responsible for, among other things, ensuring that all accounting entries were supported by adequate documentation.

RELEVANT ACCOUNTING STANDARDS

8. The accounting standards governing HCSG's identification, assessment, and measurement of loss contingencies relating to pending or threatened litigation are set forth in the Financial Accounting Standards Board's Accounting Standards Codification Topic 450, Contingencies ("ASC 450").

9. Under ASC 450-20-25-2, a loss contingency shall be accrued if (a) it is probable that an asset had been impaired or a liability had been incurred at the date of the financial

statements, and (b) the amount of loss can be reasonably estimated. A loss or liability is considered probable if it is likely to occur. ASC 450-20-20.

10. The implementation guidance for ASC 450 lists certain factors to be considered when determining the probability of an unfavorable outcome of litigation: a) the nature of the litigation, claim, or assessment; b) the progress of the case; c) the opinions or views of legal counsel and other advisers; d) the experience of the entity in similar cases; e) the experience of other entities; and f) any decision of the entity's management as to how the entity intends to respond to the lawsuit, claim, or assessment (for example, a decision to contest the case vigorously or to seek an out-of-court settlement). ASC 450-20-55-12.

11. Further, disclosure of the nature of an accrual made under ASC 450-20-25-1, and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading. ASC 450-20-50-1. Terminology used shall be descriptive of the nature of the accrual, such as estimated liability or liability of an estimated amount. *Id.*

FACTS

12. In 2013, HCSG was facing at least ten labor and employment class or collective actions brought against it on behalf of current or former employees for alleged violations of wage-and-hour labor laws. Five of these cases were filed in California state court from 2011 to 2013. By the end of 2013, HCSG had settled two of these cases for a total amount of \$6 million, with the remaining three cases pending at year-end. HCSG also was sued in five collective actions filed in 2013 under the Fair Labor Standards Act ("FLSA") in federal courts. These five FLSA cases also were pending and in various stages of litigation by year-end.

13. In general, the settlement of these types of class and collective actions are subject to court approval. After the parties reach an out-of-court settlement, through a mediation or otherwise, they submit an executed proposed settlement agreement to the court as part of a preliminary approval process. After a court grants preliminary approval of a proposed settlement, members of the class or collective are given notice of the proposed settlement terms, including the amount of attorneys' fees requested by plaintiffs' attorneys. The class or collective members then have an opportunity to object to the terms of the settlement, or in some cases, submit claims for payment. Following a prescribed time for submitting objections or claims, the court will hold a final approval hearing to consider any objections and determine whether final approval of the proposed settlement should be granted.

First Quarter of 2014

14. By Q1 2014, HCSG had determined to seek an out-of-court settlement of the three pending class-action lawsuits in California state court (collectively, the "*Irizarry*" cases) after a joint mediation of those cases with plaintiffs.⁴ Under the proposed settlement, HCSG agreed to pay between \$2.5 million and \$3 million to plaintiffs, with the final amount to be determined based

⁴ The three cases were captioned, *Irizarry v. Healthcare Svcs. Grp., Inc.*, No. BC489570 (Cal. Sup. Ct.); *Woodard v. Healthcare Svcs. Grp., Inc.*, No. BC500892 (Cal. Sup. Ct.); and *Cabrera v. Healthcare Svcs. Grp., Inc.*, No. BC503407 (Cal. Sup. Ct.). These cases were consolidated for settlement purposes under the *Irizarry* case.

on the amount of claims submitted by class members. These and other settlement terms were set forth in a proposed settlement agreement that was submitted to the court for preliminary approval in Q1 2014. Shea had participated in the mediation along with lawyers on behalf of HCSG. At all times, Shea was aware of the proposed settlement amount and the submission of the settlement agreement to the court for preliminary approval.

15. HCSG, however, did not accrue for the loss contingency related to the settlement of the *Irizarry* cases even though the loss was both probable and reasonably estimable no later than Q1 2014. Based on the information available at the time, Shea was aware that, like the other California employment class actions that HCSG had settled in 2013, HCSG intended to settle the *Irizarry* cases instead of continuing to litigate them. Shea also knew that HCSG would likely incur a liability between \$2.5 million and \$3 million under the out-of-court settlement, depending on the amount of claims submitted by class members. Shea determined that no amount for this loss contingency was probable or reasonably estimable because the *Irizarry* settlement claims process was not complete, and the settlement had not received final court approval at the time. Shea also did not maintain any documentation of any purported analysis under ASC 450 of a litigation loss contingency.

16. Shea was aware of quarterly consensus estimates of HCSG's EPS by research analysts. As a result of not accruing any amount for the *Irizarry* settlement, HCSG reported Q1 2014 EPS of \$0.21, meeting the consensus estimate. Had HCSG accrued for the settlement in this quarter, HCSG would have missed the consensus estimate by \$0.01.

17. HCSG also did not disclose the nature of this loss contingency or an estimate of the amount of loss in its Q1 2014 Form 10-Q. The Form 10-Q stated HCSG was "subject to various claims and legal actions[.]" including "payroll and employee-related matters[.]" It also stated HCSG "provide[s] accruals if the exposures [to claims and legal actions] are probable and estimable," and "[i]f an adverse outcome of such claims and legal actions is reasonably possible, we assess materiality and provide such financial disclosure, as appropriate." Notwithstanding these statements, which were repeated in other Forms 10-Q and 10-K from 2014 to 2015, HCSG did not disclose the nature or an estimate of the loss contingency for the settlement of the *Irizarry* cases under ASC 450.

Second Quarter 2014

18. By the end of Q2 2014 the court in the *Irizarry* cases had granted preliminary approval of the settlement agreement, and scheduled a final approval hearing in November 2014. Shea, however, did not direct the accrual of any amount or disclose the nature or an estimate of the *Irizarry* loss contingency because the settlement claims process was not complete, and the court had not yet granted final approval of the settlement, which was expected in Q4 2014. As a result of not accruing any amount for the settlement, HCSG reported Q2 2014 EPS of \$0.20, compared to the \$0.19 EPS HCSG had reported for Q2 2013, but less than the Q2 2014 consensus estimate of \$0.22. Had HCSG accrued for this loss contingency in this quarter, HCSG would have reported Q2 2014 EPS of \$0.19.

19. The *Irizarry* loss contingency was both probable and reasonably estimable by Q2 2014, or earlier, regardless of whether the court had granted any approval of the settlement. By the end of Q2 2014 the available information further indicated that a loss was even more likely because the court had granted preliminary approval of the settlement. Although Shea was aware of this information, he did not direct HCSG to accrue any amount for, and to disclose the nature or an estimate of, this loss contingency in HCSG's Q2 2014 filings.

Third Quarter 2014

20. In Q3 2014, HCSG reported a net loss of \$22.2 million or -\$0.31 loss per share (compared with the consensus EPS estimate of \$0.22), most of which was due to nonrecurring charges related to the creation of a captive insurance subsidiary and a corporate restructuring.

21. HCSG also accrued \$2.5 million for the settlement of the *Irizarry* cases in Q3 2014. This amount was based, in part, on the number of claims submitted under the settlement agreement – an amount that was probable and reasonably estimable no later than Q1 2014. Although the court had not yet granted final approval of the settlement agreement in Q3 2014, Shea determined that a loss arising from the settlement was probable and reasonably estimable in this period because the deadline for making claims under or objections to the settlement had passed. Shea directed the accrual of \$2.5 million in a manual journal entry made during the quarter-end closing process. By doing so, HCSG recorded this liability in a quarter when the company reported a substantial net loss and loss per share. Had HCSG accrued this liability in Q4 2014, when the final approval of the settlement was expected, it likely would have missed consensus EPS estimates for that quarter by \$0.01.

Second Quarter 2015

22. In Q2 2015, HCSG agreed to seek an out-of-court settlement of a collective action brought against it in 2013 captioned, *Kelly v. Healthcare Services Group, Inc.*, No. 2:13-cv-00441-JRG (E.D. Tex.). *Kelly* was brought on behalf of a nationwide collective of HCSG employees in federal court alleging violations of the FLSA. HCSG had vigorously contested the action for nearly two years, and was preparing for trial scheduled for July 2015. HCSG also had already paid approximately \$4 million in legal expenses for this action from 2013 to the first half of 2015, making it one of HCSG's most expensive litigations up to that point. But after the court issued mixed decisions on motions for class decertification, HCSG's potential exposure had increased dramatically. After a second mediation on June 17, 2015, which had been ordered by the court on its own motion, HCSG agreed with plaintiffs to seek an out-of-court settlement based on a settlement framework proposed by the mediator. Under the proposed settlement framework, HCSG would pay a maximum amount of \$8 million to plaintiffs, including nearly 50% of that amount, or \$4 million, in plaintiffs' attorneys' fees to be paid with HCSG stock. The day after the mediation, HCSG and plaintiffs jointly informed the court that they had reached a settlement in principle, and moved for and received a stay of proceedings to finalize a settlement agreement.

23. HCSG did not accrue any amount for the settlement of the *Kelly* action in Q2 2015. HCSG also did not disclose the nature or an estimate of this loss contingency in its filings. Shea was aware of HCSG's litigation of the *Kelly* action, including HCSG's incurred legal expenses,

increased potential exposure, and intent to seek an out-of-court settlement similar to the California class actions. Shea also knew that most of HCSG's existing legal accrual of \$4 million was for incurred legal fees for, and not for any loss contingency for settling, the *Kelly* action. But Shea determined that the loss was neither probable nor reasonably estimable because it was unclear whether the court would grant any approval of the settlement due to the amount of plaintiffs' attorneys' fees, and the payment of those fees in HCSG stock.

24. Based on the information available at the time, the loss contingency for the *Kelly* action was probable and reasonably estimable by Q2 2015 regardless of whether the court had granted any approval of the settlement, and despite any uncertainty posed by the amount of the attorneys' fees or their payment in HCSG stock. Shea was aware of this information as of Q2 2015, yet he did not direct HCSG to accrue any amount for, and to disclose the nature or an estimate of, this loss contingency in HCSG's Q2 2015 filings.

25. As a result of not accruing any loss contingency for the *Kelly* settlement, HCSG reported Q2 2015 EPS of \$0.23, which met the consensus estimate and which HCSG announced as a new company record. Had HCSG accrued a loss for the *Kelly* settlement in this quarter, it would have reported EPS of \$0.17, which would have missed the consensus estimate by 25%.

26. In addition, notwithstanding the loss for the settlement of the *Kelly* action in Q2 2015, HCSG also reduced legal expenses, without adequate documentation, resulting in HCSG reporting \$0.23 EPS for this quarter.

27. On the day of the mediation in *Kelly*, an HCSG officer asked Shea a question concerning HCSG's estimated EPS for Q2 2015. In response, Shea stated that \$0.23 – the consensus EPS estimate – “is going to be a stretch based on current [cost of services].”

28. During the quarter-end closing process, HCSG made a series of adjustments to legal expenses resulting in the increase of EPS from \$0.22 to \$0.23. On July 4, 2015, Warner informed Shea, “we are at 21.50 right now...updated legal by a credit of 200k[.]” On July 6, 2015, HCSG reduced legal expenses by another \$400,000, which resulted in an increase of EPS to \$0.23, which HCSG ultimately reported in its Q2 2015 filings. These adjustments to legal expenses were not supported by adequate documentation. Without these adjustments, HCSG would have reported Q2 2015 EPS of \$0.22, missing the consensus estimate.

Third Quarter 2015

29. In Q3 2015, HCSG had executed a settlement agreement in *Kelly*, consistent with the settlement framework HCSG had agreed to at the June 2015 mediation, and further documenting HCSG's liability of \$8 million for this loss contingency. The court granted preliminary approval of the settlement in September 2015. Shea was aware of this information by the end of Q3 2015.

30. Although HCSG had carried forward from Q2 2015 an accrual for \$4 million in legal expenses, that amount was again for incurred legal fees and not for any loss related to the *Kelly* settlement. Based on the information available at the time, the loss contingency for *Kelly*

was probable and reasonably estimable by Q3 2015, if not earlier, regardless of whether the court had granted any approval of the settlement. By Q3 2015 the available information further indicated that the settlement liability was even more likely due to the court's preliminary approval of the settlement agreement. Yet HCSG did not accrue any amount for, or disclose the nature or an estimate of, this loss contingency in HCSG's Q3 2015 filings.

31. As a result of not accruing any amount for the settlement of *Kelly*, HCSG reported Q3 2015 EPS of \$0.24, which met the consensus estimate and which HCSG announced as another company record. Had HCSG accrued for the settlement of *Kelly* in this quarter, it would have reported EPS of \$0.18, which would have missed the consensus estimate by 25%.

32. In addition, notwithstanding the loss for the settlement of the *Kelly* action in Q3 2015, HCSG also reduced accruals for legal expenses and accounting fee expenses, without adequate documentation, resulting in HCSG reporting \$0.24 EPS for this quarter.

33. During the quarter-end closing process, HCSG reduced legal expenses by \$210,000 without adequate documentation. Also, on the same date, HCSG reduced accounting fee expenses by \$104,000, again without adequate supporting documentation. HCSG recorded the accounting fee expenses in certain quarters based on the audit services received, primarily from its external auditor. Although HCSG had recorded \$202,800 in accounting fees through September 2015 based on the audit services received through the quarter, it then reversed \$104,000 of that amount without adequate supporting documentation. Warner did not ensure that there was adequate documentation supporting those reductions.

34. As a result, the \$210,000 credit to legal expenses, and the \$104,000 credit to accounting fee expenses increased HCSG's Q3 2015 EPS from \$0.23 to \$0.24. Had HCSG not reduced these expenses, HCSG would have reported EPS of \$0.23, missing the consensus estimate.

Fourth Quarter 2015

35. In Q4 2015, the court in *Kelly* entered an order granting final approval of the \$8 million settlement between plaintiffs and HCSG. HCSG recorded \$6.6 million in additional legal expenses to fully account for this liability. HCSG also issued \$4 million in HCSG shares in Q1 2016 to pay the *Kelly* plaintiffs' attorneys' fees. HCSG reported Q4 2015 EPS of \$0.13, missing the consensus estimate of \$0.26. Leading up to Q4 2015, when HCSG belatedly accrued for the *Kelly* settlement loss contingency, HCSG reported EPS that met consensus estimates in the four consecutive prior quarters, and reported three consecutive quarters of EPS growth.

HCSG's Responses to Inquiries by HCSG's External Auditor Concerning Litigation

36. During the relevant period, the *Irizarry* and *Kelly* cases described above were the subject of quarterly lawyers' letters sent to HCSG's external auditor from the law firms that represented HCSG in those cases. The letters, which were requested by HCSG's external auditor

each quarter, described the status of the cases, including settlement discussions and procedural developments. HCSG management received copies or were otherwise aware of the letters.

37. HCSG's external auditor also discussed the cases with HCSG management in connection with the external auditor's interim reviews and annual audits of HCSG's financial statements. The external auditor's working papers for the Q1-Q2 2014 and Q2-Q3 2015 interim reviews documented that, based on discussions with HCSG management, there had been no significant changes to contingent liabilities or commitments, or outstanding litigation, including the *Irizarry* and *Kelly* cases, reviewed as part of HCSG's prior year-end audit or interim review. HCSG's management, which was responsible for identifying, evaluating, and accounting for litigation loss contingencies, did not maintain any documentation of an analysis of litigation loss contingencies under ASC 450.

Respondents' Additional Accounting Entries

38. In Q3 2014, HCSG recorded \$500,000 in miscellaneous expenses for inventory that had been purchased from certain customers, although the amount was still being determined. Warner prepared the journal entry during the quarterly closing process without adequate supporting documentation.

39. During the Q4 2015 closing process Warner recorded an additional \$400,000 in accounting fee expenses without adequate supporting documentation. Although HCSG's external auditor provided substantial services in connection with HCSG's annual audit from Q4 2015 to Q1 2016, there was inadequate documentation to support recording the \$400,000 amount, more than 50% of the external auditor's annual fees, in Q4 2015.

40. During the Q4 2015 closing process Warner recorded \$300,000 in miscellaneous expense for rebate payments due to certain customers. Approximately half of this expense should have been recorded in Q3 2015 when the rebate was due, but was not recorded until Q4 2015.

41. In addition, during the closing process for Q3 2014 and Q4 2015, HCSG accrued \$1.5 million and \$1 million, respectively, in payroll and incentive compensation expense related to bonuses for certain managers. However, the documentation for these entries, which were prepared by other members of HCSG's accounting department besides Warner, did not adequately support the amounts recorded.

HCSG Lacked Accurate Books and Records and Sufficient Internal Accounting Controls, and Failed to Maintain Internal Control Over Financial Reporting

42. HCSG's accounting for litigation loss contingencies and other accounting entries that impacted net income and EPS as described above were made in part because HCSG lacked sufficient internal accounting controls over (a) accruals for litigation loss contingencies, (b) manual journal entries, and (c) period-end adjustments made during the closing process. Although HCSG had policies and procedures requiring accounting entries to have adequate supporting documentation, its finance staff regularly recorded manual journal entries with no or inadequate supporting documentation. Further, while HCSG had a Disclosure Control Committee that met

each quarter to ensure that adequate disclosure controls and procedures were developed, documented, and implemented to ensure that HCSG's financial statements and disclosures were complete and accurate, the committee's procedures were insufficient in identifying and addressing material inaccuracies in HCSG's financial statements, especially relating to the accounting for and disclosure of litigation loss contingencies. Moreover, HCSG's accounting system did not have an audit trail or time stamp function that enabled the finance staff to identify when certain manual journal entries or adjustments were made during the closing process.

43. As a result, HCSG's internal accounting controls were not designed or maintained to provide reasonable assurance that HCSG's financial statements would be presented in conformity with GAAP, and it further failed to maintain internal control over financial reporting. HCSG's books, records, and accounts also did not accurately and fairly reflect, in reasonable detail, HCSG's transactions and disposition of assets.

VIOLATIONS

44. Section 17(a)(2) of the Securities Act proscribes, in the offer or sale of a security, obtaining "money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Section 17(a)(3) of the Securities Act proscribes, in the offer or sale of a security, engaging "in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." A violation of these provisions does not require scienter and may rest on a finding of negligence. *See Aaron v. SEC*, 446, U.S. 680, 685 & 701-02 (1980).

45. Section 13(a) of the Exchange Act requires issuers to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rules 13a-1, 13a-11, and 13a-13 require issuers with securities registered under Section 12 of the Exchange Act to file annual, current, and quarterly reports, respectively. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). In addition to the information expressly required to be included in such reports, Rule 12b-20 of the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. A violation of these reporting provisions does not require scienter. *See SEC v. Wills*, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

46. Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets. Section 13(b)(2)(B) of the Exchange Act requires all reporting companies, among other things, to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP. Scienter is not an element of the books-and-records and internal accounting controls provisions. *See Ponce v. SEC*, 345 F.3d 722, 737 n.10 (9th Cir. 2003) (noting that a "plain reading of Section 13(b) reveals that it also does not

impose a scienter requirement.”). Also, Exchange Act Rule 13a-15(a) requires issuers to maintain internal control over financial reporting.

47. Rule 13b2-1 prohibits any person from directly or indirectly falsifying or causing to be falsified, any book, record, or account subject to Section 13(b)(2)(A). A violation of Rule 13b2-1 does not require scienter and may rest on a finding of negligence. *SEC v. World-Wide Coin Investments*, 567 F. Supp. 724, 749 (N.D. Ga. 1983).

FINDINGS

48. Based on the foregoing, the Commission finds that HCSG violated Securities Act Sections 17(a)(2) and 17(a)(3), and Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B), and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-15(a) thereunder.

49. Based on the foregoing, the Commission finds that Shea (a) willfully⁵ violated Securities Act Sections 17(a)(2) and 17(a)(3), and Exchange Act Rule 13b2-1; and (b) caused HCSG’s violations of Securities Act Sections 17(a)(2) and 17(a)(3), and Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B), and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-15(a) thereunder.

50. Based on the foregoing, the Commission finds that Warner caused HCSG’s violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B).

HCSG’S COOPERATION AND REMEDIAL EFFORTS

51. In determining to accept HCSG’s Offer, the Commission considered cooperation and the remedial acts promptly undertaken by HCSG to prevent and detect the type of misconduct described in the Order.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents’ Offers.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. HCSG shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-15(a) promulgated thereunder.

⁵ A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

B. Shea shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, 13a-15(a), and 13b2-1 promulgated thereunder.

C. Warner shall cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

D. Shea is denied the privilege of appearing or practicing before the Commission as an accountant.

E. After two (2) years from the date of this Order, Shea may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission (other than as a member of an audit committee, as that term is defined in Section 3(a)(58) of the Exchange Act). Such an application must satisfy the Commission that Shea's work in his practice before the Commission as an accountant will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or
2. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission as a member of an audit committee, as that term is defined in Section 3(a)(58) of the Exchange Act. Such an application will be considered on a facts and circumstances basis with respect to such membership, and the applicant's burden of demonstrating good cause for reinstatement will be particularly high given the role of the audit committee in financial and accounting matters; and/or
3. an independent accountant.

Such an application must satisfy the Commission that:

- (a) Shea, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;
- (b) Shea, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the

Respondent's or the firm's quality control system that would indicate that Shea will not receive appropriate supervision;

- (c) Shea has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and
- (d) Shea acknowledges his responsibility, as long as he appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews, and quality control standards.

F. The Commission will consider an application by Shea to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Shea's character, integrity, professional conduct, or qualifications to appear or practice before the Commission as an accountant. Whether an application demonstrates good cause will be considered on a facts and circumstances basis with due regard for protecting the integrity of the Commission's processes.

G. HCSG shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$6,000,000 to the Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying HCSG as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Anita B. Bandy, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

H. Shea shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$50,000 to the Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Shea as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Anita B. Bandy, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

I. Warner shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$10,000 to the Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Warner as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Anita B. Bandy, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

J. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Shea and Warner, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Shea and Warner under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the

violation by Shea and Warner of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Vanessa A. Countryman
Secretary