

Disclosure Games®

Healthcare Services Group SEC Probe: Many Troubling Questions Remain

Disclosure Insight® reports provide commentary and analysis on public company interactions with investors and with the SEC. They are heavily reliant on our expertise in using the Freedom of Information Act.

Summary and Opinion: *Removed from Watch List – but the danger is particularly high now.* In Aug-2018, we first warned clients about an undisclosed SEC investigation at Healthcare Services Group; [see our report published in Aug-2018](#). A surprise disclosure in early March (excerpts cited below), now tells us the investigation started much earlier, in Nov-2017. We also see it became formal by Mar-2018, with at least one subpoena sent to the company by then. Yet this was still not disclosed.

This is a company where management, for 15 months, felt the risk from its SEC investigation was not sufficiently material to require disclosure. Now they do. Why? What Changed?

This exposure is now viewed by management as so material a risk to the company it just had to be disclosed. More troubling, however, are the disclosures regarding a related internal investigation. We present the fact pattern related to this SEC investigation, the internal investigation, and explain why we say it does not add up.

– John P. Gavin, CFA

Facts of Interest or Concern: We're told an SEC accounting investigation ran for a year before an internal investigation started, with at least one subpoena sent along the way.

From the Healthcare Services Group NT 10-K filing, 04-Mar-2019:

“Additionally, during the fourth quarter of 2018, the Company authorized its outside counsel to conduct an internal investigation, under the direction of the Company’s Audit Committee, into matters related to the SEC subpoena.”

Our Take: With SEC enforcement officials at the door, it’s troubling that it took this long for an internal investigation to get started. Questions cannot help but arise regarding this company’s management team and, more importantly, the adequacy of its governance structure.

From the Healthcare Services Group NT 10-K filing, 04-Mar-2019:

“The Company currently expects to complete the internal investigation and file the Form 10-K with the SEC on or before the fifteenth calendar day following the prescribed due date.”

Healthcare Services Group is a \$2.5 billion company with \$2 billion in sales. The internal investigation only started in Q4-2018. It pertained to matters big enough to delay a 10-K filing. Yet it took just two weeks until the delayed 10-K was filed, on 18-Mar-2019.

Our Take: We find it challenging to imagine this was a credible investigation. Either the company lied about when the internal investigation really started, and it actually started much earlier. If so, that could explain how they could get the 10-K filed so quickly. But even if we allow that the internal investigation really did only start in Q4-2018, then we now have to wonder about the thoroughness of the investigation itself.

Proceed with Extreme Caution.

Our guidance in these cases is to say ignore all the speculation and guessing from analysts who don't make their living following the SEC like we do. We suggest your pressing analytical need is to assess the following –

1. What drove the company to disclose a formal SEC accounting investigation after having sat on it for so long?
2. What changed to prompt the disclosure?
3. What was the scope of, and time-span considered in, the Healthcare Services Group internal investigation? What did it find?

Here's some additional questions to consider:

- Focus on the SEC subpoena. Ask to whom it was sent and what it sought.
- Ask if there has been more than one subpoena. There often are.
- Ask if anyone has been asked to provide testimony and who they are. If so, be aware that these requests often come in the form of additional subpoenas.
- Explore around what prompted the internal investigation.
- Try to determine investigation related expenses, starting in Nov-2017.
- Finally, ask if there is more than one SEC investigation? You'd be surprised how often companies have more than the one they told you about.

From the Probes Reporter Database:

The first response we had indicating an SEC investigation was dated 04-Jun-2018, and later confirmed on 11-Jul-2018. Latest response of 08-Feb-2019, suggests SEC probe was ongoing, but the company's own disclosure now confirmed that.

Full SEC Investigation-Related Excerpts –**From the Healthcare Services Group, Inc. 10-K, filed 18-Mar-2019 –**

The SEC's investigation into our earnings per share ("EPS") calculation practices could result in potential sanctions or penalties, distraction to our management and result in litigation from third parties, each of which could adversely affect or cause variability in our financial results.

Beginning in November 2017, the Company has been in dialogue with the SEC regarding EPS calculation, rounding and reporting practices and in March 2018 we learned that the SEC had opened a formal investigation into these matters. In response to the SEC's investigation, during the fourth quarter of 2018, the Company authorized its outside counsel to conduct an internal investigation, under the direction of the Company's Audit Committee regarding these matters. The internal investigation was completed in March 2019, prior to the filing of this Annual Report on Form 10-K.

Notwithstanding the completion of the internal investigation, the SEC's investigation is ongoing and there can be no assurance that the SEC or another regulatory body will not make further regulatory inquiries or pursue further action that could result in significant costs and expenses including potential sanctions or penalties as well as distraction to management. In addition, the Company may be subject to litigation from third parties related to the matters under review by the SEC. Accordingly, the ongoing SEC investigation and/or any related litigation could adversely affect or cause variability in our financial results.

Failure to maintain effective internal control over financial reporting could have a material adverse effect on our ability to report our financial results on a timely and accurate basis.

Failure to maintain appropriate and effective internal controls over our financial reporting could result in misstatements in our financial statements and potentially subject us to sanctions or investigations by the SEC or other regulatory authorities, and could cause us to delay the filing of required reports with the SEC and our reporting of financial results. Any of

these events could result in a decline in the market price of our Common Stock. Although we have taken steps to maintain our internal control structure as required, we cannot guarantee that control deficiencies will not result in a misstatement in the future.

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From the Healthcare Services Group, Inc. NT 10-K, filed 04-Mar-2019 –

Healthcare Services Group, Inc. (the “Company”) has determined it is unable to file its Annual Report on Form 10-K for the year ended December 31, 2018 (the “Form 10-K”) within the prescribed time period, without unreasonable effort or expense, due to the circumstances described below.

The Company received a letter in November 2017 from the Securities and Exchange Commission (the “SEC”) regarding an inquiry that the SEC is conducting into earnings per share (“EPS”) calculation practices and requesting that the Company voluntarily provide certain information and documents relating to its EPS rounding and reporting practices. The Company also received a subpoena in March 2018 from the SEC in connection with these matters.

Since the inception of the inquiry, the Company has been providing information and documents to the

SEC. Additionally, during the fourth quarter of 2018, the Company authorized its outside counsel to conduct an internal investigation, under the direction of the Company’s Audit Committee, into matters related to the SEC subpoena. The Company continues to cooperate with the SEC’s investigation.

The Company and its outside counsel continue to work expeditiously to conclude the internal investigation and have determined to delay the filing of the Form 10-K until the Audit Committee determines that the internal investigation is complete. The Company currently expects to complete the internal investigation and file the Form 10-K with the SEC on or before the fifteenth calendar day following the prescribed due date. [Probes Reporter Note: This entire paragraph was missing from the related 8-K filed that same day the NT 10-K was filed.]

The Company does not expect the Form 10-K to reflect any changes to its results of operations as previously reported in its most recent earnings release for the three months ended December 31, 2018 and the year ended December 31, 2018.

– Probes Reporter



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“Disclosure Games”® is a term we use to highlight those public companies engaging in disclosure practices that in our opinion may be misleading, confusing, evasive, or otherwise lacking the transparency needed for investors to make well-informed investment decisions regarding a potentially material exposure.

If we alert you to existence of an undisclosed SEC probe, that means we filed a Freedom of Information Act (FOIA) request with the SEC on the company in question and have a response, in black-and-white, on government letterhead that supports our statement. The only thing we know at this time is that the probe(s) somehow pertains to the conduct, transactions, and/or disclosures of the companies referenced.

New SEC investigative activity could theoretically begin or end after the date covered by the latest information in this report which would not be reflected here. The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced above. Companies with undisclosed SEC investigations are maintained on our Watch List of companies with undisclosed SEC probes.

The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security.

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