UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 11039 / March 16, 2022

SECURITIES EXCHANGE ACT OF 1934
Release No. 94425 / March 16, 2022

ADMINISTRATIVE PROCEEDING
File No. 3-20799

In the Matter of **CROSBY INDEPENDENT SCHOOL DISTRICT,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted 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 Crosby Independent School District ("Crosby," the "District," or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), 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 it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

1. In January 2018, Crosby Independent School District raised $20 million through the sale of municipal bonds (the "January 2018 Bonds"). Crosby's Official Statement for the January 2018 Bonds, which was used to solicit interest from prospective investors, contained Crosby's fiscal year 2017 audited financial statements. Unknown to investors at the time, Crosby had failed to report payroll and construction liabilities totaling $11.7 million. Consequently, Crosby's audited financial statements falsely reported General Fund reserves of $5.4 million. When these misstatements were discovered, Crosby declared financial exigency and the bonds were downgraded.

2. Crosby knew that its payroll and construction liabilities were higher than the amounts recorded in its fiscal year 2017 audited financial statements. Crosby, however, failed to determine the true amount of the liabilities and never informed its auditor that the fiscal year 2017 payroll and construction liabilities were understated. Nonetheless, Crosby submitted its fiscal year 2017 audited financial statements to the bond financing team to be included in relevant offering documents, which were provided to prospective investors.

3. Through this conduct and its misstatements, Crosby violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

B. RESPONDENT

4. **Crosby Independent School District** is a public school district based in Crosby, Texas, a suburb located northeast of Houston, Texas. Crosby operates seven schools and serves approximately 6,400 students. It is governed by a seven-member elected Board of Trustees. Crosby operates on a July 1 to June 30 fiscal year.

C. OTHER RELEVANT INDIVIDUAL

5. **Carla Merka** age 57, is a resident of Dayton, Texas. Merka served as Crosby's Chief Financial Officer ("CFO") from approximately March 2014 through May 2018. As CFO, Merka had primary responsibility over Crosby's bond, business, and finance programs, as well as its financial statements. In approximately June 2018, Merka left Crosby for other employment.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

D. FACTS

<u>Crosby's Deteriorating Financial Condition and Change to Fiscal Year End</u>

6. In 2013, Crosby issued $86.5 million in municipal bonds ("2013 Bond") to fund several capital projects. Crosby knew that various project enhancements beyond the original scope of work inflated the total cost of the projects. Consequently, the 2013 Bond proceeds were prematurely exhausted in fiscal year 2016 leaving the General Fund as the only source of funding for approximately $12 million of remaining construction commitments.

7. As of August 31, 2016 (Crosby's then fiscal year-end), Crosby and Merka knew that the District's General Fund lacked sufficient funds to cover the $12 million of unanticipated construction expenses required to complete its capital projects. As a result, Crosby pursued two options to pay for the remaining construction costs: (1) Crosby changed its fiscal year-end date from August 31 to June 30, and (2) Crosby issued new municipal bonds.

<u>Crosby's Fiscal Year 2017 Financial Statements Were Materially Misstated</u>

8. Crosby's fiscal year 2017 financial statements materially understated liabilities and overstated the General Fund balance due to two significant failures: (1) failure to record construction expenses for completed capital projects, and (2) failure to record payroll expenses for unpaid teachers' salaries.

Crosby Understated Construction Expenses by $7.9 Million

9. During the fiscal year 2017 audit, Crosby and Merka knew that the 2013 Bond proceeds had been completely consumed and Crosby would have to pay the remaining construction commitments from its General Fund. Crosby and Merka also knew that Crosby's capital projects had been substantially completed and that Crosby's General Fund lacked sufficient funds to pay the estimated $8-$10 million in unpaid construction invoices. In early June 2017, officers from Crosby discussed with its municipal advisor that it did not have enough funds to cover its normal operating expenses and the unpaid construction expenses. On June 26, 2017, Crosby's municipal advisor convened a call with officers from Crosby, including Merka, Crosby's bond counsel, and Crosby's auditor. On that call, Crosby and its municipal advisor concluded that the District could not pay for its outstanding construction commitments without issuing new bonds.

10. Crosby failed to accurately record its unpaid construction liability in the fiscal year 2017 financial statements. Crosby only recorded a construction liability of $727,000 despite knowing that the outstanding construction liability was much greater. Merka failed to provide accurate information regarding Crosby's construction expenses to the district's auditor. Merka reviewed and approved the fiscal year 2017 financial statements and signed a management representation letter falsely asserting that, among other things, the fiscal year 2017 financial statements were presented in accordance with GAAP and that the District's net position and fund balance had been properly reported.

Crosby Understated Payroll Expenses by $3.8 million

11. Crosby's teacher salaries represented a majority of the District's expenses. Teachers earn their salaries over a 10-month contract period corresponding with the start and end of the school year, though they were paid evenly over a 12-month period ending in mid-August. Crosby was not required to record a payroll liability for teacher salaries when its fiscal year-end was August 31 because all teacher contracts had been paid in full as of that date. Crosby changed its fiscal year-end date from August 31 to June 30 for multiple reasons, including a failed attempt to increase General Fund reserves and pay for the 2013 Bond construction projects. When Crosby moved its fiscal year-end date, however, Crosby concluded fiscal year 2017 with unpaid payroll obligations related to the 2017 contract year (amounts paid in July 2017 and August 2017). Crosby failed to include these unpaid payroll liabilities in its fiscal year 2017 financial statements.

12. Crosby knew that the change in fiscal year-end date would result in a payroll liability for teacher salaries, but did not properly account for it. Crosby and Merka also knew that Crosby's auditor incorrectly believed that all contractual employees had been paid in full as of June 30, 2017. Merka never corrected this misunderstanding, nor did Merka calculate her own payroll liability. Instead, Crosby recorded only a $30,000 payroll liability related to hourly employees. Merka knew that the payroll liability was understated, but still signed a management representation letter falsely asserting that, among other things, the fiscal year 2017 financial statements were presented in accordance with GAAP and that the District's net position and fund balance had been properly reported.

<u>Crosby's January 2018 Bond Documents Contained Material Misstatements and Omissions</u>

13. On January 18, 2018, Crosby issued $20 million of Unlimited Tax School Building Bonds to pay its outstanding construction liabilities and to fund new capital projects. Crosby's false and misleading fiscal year 2017 financial statements were appended to the official statement used to market the bonds to investors. Crosby's fiscal year 2017 audited financial statements understated payroll and construction liabilities by $3.8 million and $7.9 million, respectively. These errors resulted in an overstatement of Crosby's General Fund reserves by $11.7 million. Most importantly, Crosby's fiscal year 2017 financials reported a positive General Fund balance when it should have reported a negative one. Crosby's official statement also disclosed information concerning the District's fiscal year 2017 deficit. The disclosures in this section of the official statement were false and misleading because they did not include the appropriate payroll and construction liabilities.

14. As CFO, Merka had ultimate responsibility over Crosby's fiscal year 2017 financial statements. She was responsible for reporting on financial issues to Crosby's Board and was Crosby's primary contact during the bond financing process. Merka and other officers from Crosby reviewed Crosby's official statement prior to its release to prospective investors. Crosby's then Board President signed Crosby's official statement used to market the bonds to investors.

15. Crosby knew that its fiscal year 2017 financial statements were false and misleading, yet submitted them to the bond financing team for inclusion in the offering documents.

In fact, Merka did not invite its external auditor to meetings with the bond financing team despite Crosby's municipal advisor making such a request. Nor did Merka reveal in communications with ratings agencies the District's true financial condition.

<u>Crosby's Declaration of Financial Exigency, Rating Downgrades, and Restatement</u>

16. During spring 2018, Crosby continued to face cash flow shortages because of the additional construction expenses. In June 2018, Crosby's new CFO discovered the payroll and construction liability errors. In August 2018, Crosby's leadership disclosed the financial issues to its Board and the public, and began crafting a financial recovery plan with its municipal advisor. Beginning in September 2018, ratings agencies downgraded Crosby's bonds.

17. On October 8, 2018, Crosby declared a financial exigency and implemented a mid-year reduction in force. Crosby's declaration of financial exigency required that a monitor from the Texas Education Agency oversee the District's finances and efforts to achieve financial solvency; the monitor is still in place. In February 2019, Crosby's auditor issued its audit report for Crosby's fiscal year 2018 financial statements, which included material restatements of the fiscal year 2017 ending balances and raised doubts about Crosby's ability to continue as a going concern.

18. Throughout the fall of 2018 and into 2019, the District's new CFO and Superintendent executed on a short and long-term plan to help the District solve its financial problems. These actions included budget cuts, a hiring freeze, reductions in force, examination of all expenses, and investigation of the previous conduct.

E. VIOLATIONS

19. A statement or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

20. As a result of the conduct described above, Crosby violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act. Crosby, through the January 2018 Bond documents that appended the District's false and misleading fiscal year 2017 financial statements, made untrue statements of material fact or misleading omissions in connection with the purchase or sale of securities and in the offer or sale of such securities. Crosby further engaged in transactions, practices, and a course of business that operated as a fraud or deceit on the investors in the January 2018 Bonds. Crosby allowed the dissemination of the false and misleading financial statements and engaged in other actions that concealed the District's financial distress at the time of the January 2018 bond sale.

F. CROSBY'S REMEDIAL EFFORTS AND COOPERATION

21. In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Crosby's Offer.

Accordingly, it is hereby ORDERED that**:**

Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act that Respondent Crosby cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

By the Commission.

Vanessa A. Countryman
Secretary