

**UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION**

SECURITIES AND EXCHANGE COMMISSION,)	
)	
Plaintiff,)	Civil Action No.: 4:22-cv-841
)	
v.)	
)	
CARLA MERKA,)	
)	
Defendant.)	
)	

COMPLAINT

Plaintiff United States Securities and Exchange Commission (the “SEC”) alleges:

SUMMARY OF ALLEGATIONS

1. In January 2018, Crosby Independent School District (“Crosby” or the “District”) issued \$20 million in municipal bonds using audited financial statements from Crosby’s fiscal year 2017 (“FY17”). Crosby’s FY17 financial statements failed to report \$11.7 million in payroll and construction liabilities for the District and falsely reported \$5.4 million in reserves in the District’s General Fund. Crosby disclosed its depletion of General Fund reserves to the public in August 2018 and the District declared a financial exigency and instituted mid-year layoffs. Additionally, S&P downgraded Crosby’s bonds to A- from AA- as a result of the restatement and “rapid deterioration” of the District’s reserves. In February 2019, the District restated its FY17 General Fund reserves to negative (\$6.3) million.

2. Prior to the issuance of the bonds, Crosby’s Chief Financial Officer, Carla Merka, knew that Crosby’s payroll and construction liabilities were significantly higher than the amounts recorded in the FY17 audited financial statements. Merka, however, failed to determine the true amount of the liabilities, and never informed Crosby’s auditors that she knew that the FY17 payroll

and construction liabilities were substantially understated. Merka nonetheless submitted Crosby's FY17 audited financial statements to the bond financing team to be included in the offering documents, which Merka knew were disclosed to prospective investors.

3. As a result of this conduct, Merka violated Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder.

DEFENDANT

4. **Carla Merka**, age 57, is a resident of Dayton, Texas. Merka has over twenty years of accounting experience, but has never been a CPA or held any professional accounting license. From March 2014 through May 2018, she served as Crosby's CFO. As Crosby's CFO, Merka supervised at least eight accounting employees and had primary responsibility over the preparation of Crosby's financial statements and interaction with Crosby's external auditor. In June 2018, Merka left Crosby to become CFO of another independent school district in Texas, a position she continues to hold.

OTHER RELEVANT ENTITY

5. **Crosby Independent School District** is a public school district based in Crosby, Texas, a suburb northeast of Houston, Texas. Crosby operates seven schools and serves approximately 6,400 students.

JURISDICTION AND VENUE

6. The SEC brings this action pursuant to authority conferred upon it by Sections 20(b) and 20(d) of the Securities Act [15 U.S.C. §§ 77t(b) and 77t(d)] and Sections 21(d) and 21(e) of the Exchange Act [15 U.S.C. §§ 78u(d) and 78(u)(e)].

7. This Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

8. Venue is proper in this District, because Crosby is located within this District and the acts constituting violations of the federal securities laws alleged in this Complaint occurred within this District.

9. In connection with the conduct described in this Complaint, Defendant directly or indirectly made use of the mails or the means or instruments of transportation or communication in interstate commerce.

FACTUAL ALLEGATIONS

A. Crosby Lacked Funds to Complete Capital Projects

10. In 2013, Crosby issued \$86.5 million in municipal bonds (“2013 Bond”) to fund various capital projects, including the construction of a baseball and softball complex and renovations to its football stadium. The District hired a general contractor and a project and risk manager to undertake these projects, which were expected to be completed by May 2017. Crosby’s then-Superintendent was actively involved in the construction projects, and personally directed contractors to perform project enhancements outside the original scope of work, which inflated the total cost of the projects.

11. In part because of the project enhancements, the District exhausted the 2013 Bond proceeds prematurely, leaving the General Fund as the only available source of funding for approximately \$12 million of future construction commitments.

12. Merka knew of the inflated costs and the exhaustion of the 2013 Bond proceeds. Accordingly, she was concerned that the District did not have enough funds to complete the construction projects, and was actively pursuing alternative sources of funding.

13. By August 31, 2016, Crosby's then fiscal year-end, the District's General Fund lacked sufficient funds to cover the \$12 million of future construction expenses required to complete its capital projects. For multiple reasons, including to increase General Fund reserves and pay for the 2013 Bond construction projects, Merka suggested, and Crosby's Board approved, changing the District's fiscal year-end date from August 31 to June 30. Merka incorrectly believed that shifting the fiscal year-end would create "a one-time savings" of approximately \$10 million. While the change shortened Crosby's FY17 to 10 months – from September 1, 2016 to June 30, 2017 – it did not generate the savings needed to cover the construction commitments, and the District concluded its FY17 with a decrease in General Fund reserves of \$5.2 million.

B. Crosby's FY17 Financial Reporting Failures

14. Merka prepared FY17 financial statements for Crosby that materially understated liabilities and overstated the General Fund balance. In particular, the FY17 financial statements (1) failed to report construction expenses for completed capital projects, and (2) failed to report unpaid payroll expenses due to the change in fiscal year-end. Merka knew that Crosby had incurred (but had not paid) these expenses as of June 30, 2017, but failed to record those liabilities in the financial statements and failed to communicate to the District's auditor the magnitude of the unpaid liabilities.

i. Merka Understated Construction Expenses

15. Beginning in FY16, Merka knew that the 2013 Bond proceeds had been completely consumed and Crosby would need to use the General Fund to pay all remaining construction commitments. By May 2017, the capital projects were substantially completed, but Crosby lacked

sufficient funds in its General Fund to pay the estimated \$8 million to \$10 million in outstanding, unpaid construction invoices.

16. In early June 2017, Merka began sending concerned emails to Crosby's superintendent and the District's municipal financial advisor, indicating that Crosby did not have enough funds to cover its normal operational expenses and the unpaid construction expenses. Because Crosby could not pay for its outstanding construction commitments without raising new bond proceeds, the District persuaded its primary construction contractor to defer Crosby's outstanding payment obligations until the District received proceeds from a new bond issuance.

17. Instead of accurately recording Crosby's unpaid construction liability of more than \$8 million, the District's FY17 financial statements showed a construction liability of only \$727,000. Merka reviewed and approved the FY17 financial statements and signed a management representation letter sent to Crosby's auditor falsely asserting that, among other things, the FY17 financial statements were presented in accordance with GAAP and that the District's net position and General Fund balance had been properly reported.

ii. Merka Understated Payroll Expenses

18. Crosby's teachers are considered "contractual" employees and represent the vast majority of the District's payroll expenses. Their term begins at the start of each school year, typically in mid-August. Most Crosby teachers earn their salaries over a 10-month "contract" period corresponding with the start and end of the school year. All contractual employees, however, are paid evenly over a 12-month period. As a result, Crosby's teachers are not fully compensated for their 10-month earnings until the 12-month term expires.

19. Prior to FY17, Crosby did not need to record a payroll liability for its teachers at the end of a fiscal year, because the contractual commitments for the preceding school year had

been paid in full by the end of the fiscal year, August 31. By changing its fiscal year-end date from August 31 to June 30, Crosby concluded FY17 with unpaid payroll obligations related to the 2017 *contract* year. In other words, Crosby still had to pay its teachers for two more months – July and August 2017. Crosby, however, failed to include these unpaid payroll liabilities, which amounted to \$3.8 million, in its FY17 financial statements. Merka knew that Crosby’s auditor incorrectly believed that all contractual employees had been paid in full as of June 30, 2017 and did not correct this misunderstanding.

20. While knowing that Crosby’s payroll liability was understated, Merka reviewed and approved the FY17 financial statements and signed a management representation letter sent to the auditor that falsely asserted that, among other things, the FY17 financial statements were presented in accordance with GAAP and that the District’s net position and fund balance had been properly reported.

C. Crosby’s Offering Documents for the 2018 Bonds Contained Material Misstatements and Omission

21. On January 18, 2018, Crosby issued \$20 million of Unlimited Tax School Building Bonds to pay its outstanding construction payables and to fund new capital projects. Crosby’s erroneous FY17 financial statements were appended to the Official Statement, a document disclosed to prospective investors describing the essential terms of the bonds.

22. As discussed in paragraphs 15-20 above, Crosby’s FY17 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. Notably, Crosby’s FY17 financials reported a *positive* General Fund balance when it should have reported a *negative* one. Crosby’s Official Statement disclosed information concerning the District’s FY17 fiscal year deficit, but the disclosures in this section were false and

misleading because they did not include the payroll and construction expenses discussed in paragraphs 15-20 above.

23. The misrepresentations and omissions in Crosby's FY17 financial statements were material to bond investors, significantly altering the total mix of information available to them in determining whether to purchase the bonds.

24. As CFO, Merka had the ultimate authority over Crosby's FY17 financial statements. She was Crosby's highest-ranking executive with any financial or accounting experience. Merka was responsible for reporting on financial issues to Crosby's Board and often made presentations on those subjects. The leadership of the District relied on Merka to ensure the financial statements were complete and accurate. Merka was also the District's representative in multiple meetings and calls with the District's financial advisor leading up to the bond offering, including discussions related to "cash flow forecasts, FYE 2017 ending numbers, required disclosures, bond ratings, Plan of Finance, and Board presentations." Additionally, Merka was the main point of contact for the District's disclosure counsel, who sent her questionnaires to complete for purposes of drafting the Official Statement disclosures. Merka reviewed Crosby's Official Statement prior to its release to prospective investors.

25. Merka knew that Crosby's FY17 financial statements were false and misleading, yet submitted them to the bond financing team for inclusion in the package of offering documents. Merka did not invite the District's external auditor to meetings with the bond financing team despite Crosby's municipal advisor making such a request. Similarly, Merka did not reveal in communications with ratings agencies the District's true financial condition.

D. Discovery of Crosby's Financial Issues and Aftermath

26. Crosby's superintendent resigned in January 2018. Merka resigned at the end of May 2018 and accepted a CFO position at another independent school district in Texas. Crosby hired a new CFO and Superintendent, who assumed their positions in June and July 2018, respectively.

27. During spring 2018, Crosby continued to face cash flow shortages due, in part, to the construction expenses described above. Shortly after arriving in June 2018, Crosby's new CFO discovered the payroll and construction liability errors and confronted the District's auditor about the significant financial shortfalls.

28. 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 financial advisor. On September 25, 2018, Moody's downgraded Crosby's bonds from A1 to A3 and placed the rating under review for further possible downgrade. In December 2018, Moody's changed its outlook on the 2018 Crosby bonds to "negative."

29. On October 8, 2018, Crosby's Board declared a financial exigency with the Texas Education Agency (TEA), which allowed the District to implement a mid-year reduction in force. On December 6, 2018, S&P downgraded Crosby's bonds to A- from AA- due to "the district's rapid deterioration of reserves stemming from overspending, overestimating revenues, and a mistake in the audit that led to a negative prior period adjustment and the depletion of reserves." S&P also changed its outlook on Crosby bonds from "stable" to "negative." In February 2019, the District's auditor issued its audit report for Crosby's FY18 financial statements, which included material restatements of the FY17 ending balances.

FIRST CLAIM FOR RELIEF
Fraud in the Offer or Sale of Securities
Sections 17(a)(1) and 17(a)(3) of the Securities Act

30. The SEC incorporates the allegations in paragraphs 1 through 29 as if fully set forth herein.

31. By engaging in the acts and conduct alleged herein, Defendant, directly or indirectly, in the offer or sale of securities, by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, has:

- a. knowingly or with severe recklessness employed a device, scheme, or artifice to defraud; and
- b. knowingly, recklessly, or negligently engaged in a transaction, practice, or course of business which operated or would operate as a fraud or deceit upon the purchaser.

32. Defendant violated and, unless restrained and enjoined, will continue to violate Sections 17(a)(1) and 17(a)(3) of the Securities Act [15 U.S.C. § 77q(a)(1) and (3)].

SECOND CLAIM FOR RELIEF
Fraud in Connection with the Purchase or Sale of Securities
Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

33. The SEC incorporates the allegations in paragraphs 1 through 29 as if fully set forth herein.

34. By engaging in the acts and conduct alleged herein, Defendant, directly or indirectly, in connection with the purchase or sale of securities, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, knowingly or with severe recklessness:

- a. employed a device, scheme, or artifice to defraud;

- b. made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and
- c. engaged in an act, practice, or course of business which operated or would operate as a fraud or deceit upon any person.

35. Defendant violated and, unless restrained and enjoined, will continue to violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

RELIEF REQUESTED

WHEREFORE, the SEC respectfully requests that this Court enter a judgment:

I.

Finding that the Defendant committed the violations alleged in this Complaint.

II.

Permanently enjoining, pursuant to Rule 65(d) of the Federal Rules of Civil Procedure, the Defendant from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)] and Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

III.

Ordering Defendant to pay a civil penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

IV.

Permanently barring Defendant from participating in any offering of municipal securities, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or

inducing or attempting to induce the purchase or sale of any municipal security, provided however, that such injunction shall not prevent Defendant from purchasing or selling municipal securities for her own personal account.

V.

Retaining jurisdiction over this action to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

VI.

Granting such other and further relief as this Court deems just and appropriate.

Dated: March 16, 2022

Respectfully submitted,



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