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SEC Settles Municipal Bond Fraud Case Against Texas School District and Former CFO, and Suspends External Auditor.

On March 16, the SEC filed a municipal bond fraud case against Crosby Independent School District and its former CFO in a \$20 million bond offering.¹ Crosby is a suburb of Houston, Texas. The SEC also charged the district's outside auditor with improper professional conduct and suspended her from appearing or practicing before the Commission with a right to reapply after three years.

A review of the allegations reveals that the case involved classic financial reporting fraud. The SEC alleged that Crosby ISD's year-end 2017 financial statements seriously understated its payroll and construction liabilities by failing to report some \$11.7 million of such liabilities. Those same audited financial statements also contained false claims that the district had \$5.4 million in general fund reserves, thereby substantially overstating its assets. According to the Commission, the district and the then-CFO knew that the financial statements were false but issued them anyway. The CFO also allegedly signed false management representation letters. The false statements also appeared in the offering documents for the municipal bond sale.

The fraud allegedly came to light in June 2018 when the successor CFO discovered the misstatements. In August 2018, seven months after the offering, the district disclosed significant financial distress, including that it had a negative general fund balance. The following month, ratings agencies downgraded the district's bonds.

The audit partner agreed to a suspension from appearing or practicing before the Commission under Rule 102(e) of the Commission's Rules of Practice.² The Commission charged her with improper professional conduct, including failure to obtain sufficient audit evidence, improper supervision of the audit, and lapses in professional judgment and professional skepticism.

The settlements with the district and the former CFO, which were made on a neither-admit-nor-deny basis, involve alleged violations of the antifraud provisions of the federal securities laws, including Exchange Act Section 10(b) and Exchange Act Rule 10b-5.³ The former CFO agreed to pay a \$30,000 penalty and not participate in any future municipal securities offerings.

The case is a reminder that the SEC is the cop on the beat in municipal securities offerings and will enforce the securities laws when violations occur.

Footnotes

1. SEC Press Release, *SEC Charges Texas School District and its Former CFO with Fraud in \$20 Million Bond Sale* (Mar. 16, 2022), available [here](#).
2. Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities

Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions, Securities Exchange Act Release No. 94426 (Mar. 16, 2022), available [here](#).

3. 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, Securities Act Release No. 11039 (Mar. 16, 2022), available [here](#).

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