

Bond Case Briefs

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SEC Charges School District, the District's Former Chief Financial Officer and the District's Auditor with Violations of Federal Securities Laws in a 2018 Bond Offering.

On March 16, 2022, the Securities and Exchange Commission ("SEC") entered an order against a school district (Crosby Independent School District (the "District"), located in a suburb of Houston, Texas) and against the District's auditor (the "Auditor") and charged the school district's former chief financial officer ("CFO") with misleading investors who purchased \$20 million of the District's 2018 bonds (the "Bonds").

In its actions, the SEC noted that the District, the CFO and the Auditor included false and misleading audited financial statements in the official statement for the Bonds. Specifically, the FY2017 financial statements underreported construction liabilities (by \$7.9 million) and payroll expenses (by \$3.8 million) resulting in the financial statements overstating the general fund balance by \$11.7 million. The District submitted the FY2017 financial statements for use with the offering document, the District and the CFO reviewed the offering document prior to its use in marketing the Bonds, and the school board's president signed the offering document. The District changed its fiscal year end as part of a plan to address the District's financial condition prior to offering the Bonds, and the change in fiscal year end should have prompted a heightened level of scrutiny on the Auditor's part. The SEC determined that the Auditor's audit procedures were deficient.

The District. The charges against the District were brought under the Securities Exchange Act of 1934 ("1934 Act") Section 10(b) and Rule 10(b)(5) thereunder and the Securities Act of 1933 ("1933 Act") Section 17(a). Violations of 1933 Act Section 17(a) do not require intentional wrongdoing on the part of the actor and can be established on the basis of negligence. The SEC's order against the District found that it violated 1934 Act Section 10(b) and Rule 10b-5 thereunder and 1933 Act Section 17(a). The District was ordered to cease and desist from committing or causing any violations and any future violations of 1934 Act Section 10(b) and Rule 10b-5 and 1933 Act Section 17(a).

The CFO. The SEC alleged the CFO violated 1933 Act Section 17(a)(1) and (3) and 1934 Act Section 10(b) and Rule 10b-5. The CFO has agreed to settle with the SEC, including paying a \$30,000 penalty and not participating in any future municipal securities offerings. The settlement is pending court approval.

The Auditor. The SEC's order against the Auditor found that she engaged in improper professional conduct pursuant to 1934 Act Section 4C(2) and SEC Rules of Practice Rule 102(e)(1)(ii). The SEC's order was effective immediately and denied the Auditor the privilege of appearing or practicing before the SEC as an accountant.

A similar recent case. This set of cases follows SEC actions from September 2021 involving a California school district and its CFO wherein that California school district included misleading budget projections in its offering documents for its bonds due to the budget's failure to reflect salary increases. Despite reports showing actual expenses were higher than projected, the California

school district used the stale information and the CFO attested to the accuracy of the information in the offering document. The SEC order against the California school district found that it violated 1933 Act Section 17(a)(2) and (3) by “making misleading statements and omissions to investors, as well as to the bonds’ credit rating agency and other municipal industry professionals on the transaction.” The California school district was ordered to cease and desist violating 1933 Act Section 17(a)(2) and (3), implement various written policies and procedures, conduct staff training, retain an independent consultant to review the policies and procedures, implement recommendations of the independent consultant, disclose this settlement in future bond offerings, and provide certifications of compliance to the Staff of the SEC regarding these settlement conditions. The SEC charged the former CFO with violating 1933 Act Section 17(a)(3).

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April 15, 2022