MusclePharm and Execs in HOT Water Over SEC Audit

written by Mike Roberto | September 9, 2015

If you thought an FDA Audit was bad, try getting audited by the SEC

Have you ever wondered where the profits went after buying something from MusclePharm over the past few years? Prepare to find out.

*(Hint: for those of you thinking about guessing **childbirth costs**, you wouldn't be wrong!)*

Just when all the dust started to settle on the amino acid spiking allegations in the Arnold Series weight gainer, MusclePharm (MSLP) finds itself embroiled in a brand new controversy!

The *Athlete's Company* may be in for a whole mess of trouble based off the findings of a new report from the US Federal Securities and Exchange Commission (SEC).

The SEC press release charged the supplement giant with infractions related to a number of accounting and disclosure violations.[1] The investigation found that MP failed to report, or grossly misrepresented, approximately $500,000 in benefits paid to three current or former executives and chairmen.

MusclePharm's SEC Audit

The release puts it relatively bluntly:

> *"An SEC investigation found that MusclePharm omitted or*

> *understated nearly a **half-million dollars' worth of perks** bestowed upon its executives, including approximately **$244,000 paid to CEO Brad Pyatt related to automobiles, apparel, meals, golf club memberships**, and his personal tax and legal services.[1]*

Further,

> *Even after the company began an internal review of undisclosed executive perks and then-audit committee chair Donald Prosser became directly involved in the process, MusclePharm continued filing financial statements that **failed to disclose private jet use, vehicles, and golf club memberships** for its executives.[1]"*

(All emphasis is ours throughout this article.)

$MSLP is a *public* company, not a private one!

Before we go any further, let us remind you that MusclePharm is a *publicly traded company*, governed by the rules and laws of the SEC. Their stock ticker is MSLP,[2] traded on the OTC markets.

As such, this is all information that must be disclosed to investors.

Director of the SEC's Division of Enforcement Andrew J. Ceresney said,

> *"Executive compensation is material information for investors, and companies must ensure that perks it pays for executives are properly recorded and disclosed in public filings…Prosser, MusclePharm's audit committee chair, subjected himself to liability when he substituted his wrong interpretation of SEC rules for the views of experts the company had hired, resulting in an incorrect disclosure.[1]"*

On the top-right of the SEC press release page, you will find five links to the PDFs of the actual SEC Orders.

Specific findings

Details of the violations are fairly egregious, but perhaps not the end of the world. Here’s the specifics based on the SEC findings:

- **Failure to report $244,000 paid to CEO Brad Pyatt** for cars, clothing, meals, tax/legal services and golf club memberships

  Following an internal review from then audit-committee Chairman Donald Prosser, MP *continued* to not disclose executives use of private jets, cars and golf club memberships

  - *MSLP also paid for perquisites of other executives that were not disclosed, including items such as **the medical costs of the birth of a child…***

- Failure to report financial transactions with a “major customer” while failing to implement policies to identify their “major customers”
- Improperly recorded promotional and advertising costs which led to **grossly overstated revenue**
- **Failure to disclose bankruptcies** filed by two executive officers (L. Gary Davis and Lawrence Meer)
- **Failure to divulge sponsorship commitments** with payments totaling **$6.9 million**
- **Misrepresented rent expenses for an aircraft** lease agreement totaling $100,000
- Failure to implement internal accounting monitoring for benefits where violations occurred
- Issuing stock certifications to 3rd parties without registration in exchange for cash compensation to MP vendors

Outside of these findings, MusclePharm and the four individuals mentioned above settled their grievances without so much as an acknowledgment or denial of the SEC report.[3] MP did agree to pay $700,000 in penalty fees, as well as hire an independent “watchdog” for one year.

Additionally, CEO Brad Pyatt will pay a $150,000 penalty and Prosser and Davis each will pay $30,000 in penalty fees. Davis and Meer will be suspended from accounting for two and three years, respectively, from any SEC-regulated dealings.

From the SEC’s own voice:

Below are some select quotes from the SEC’s own documents, which are surprisingly easy to read:

> *MSLP’s senior management lacked public company or accounting experience.[3]*

> *While the company focused on revenue growth, it* ***failed to establish sufficient internal controls and keep proper books*** *and records. As a result, between 2010 and 2013, MSLP engaged in a series of accounting and disclosure failures that resulted in the company* ***filing materially false and misleading filings*** *with the Commission from 2010 through July 2014.[3]*

Childbirth costs? The athlete’s company’s got you, babe!

> *During this time, MSLP also paid for perquisites of other executives that were not disclosed, including items such as* ***the medical costs of the birth of a child, eye surgery****, and personal golf club memberships.[3]*

MusclePharm’s Penalties

Unlike what we’ve seen with various ongoing FDA battles, the penalties are swift and harsh:

> *Respondent shall pay civil penalties of $700,000 to the Commission. Payment shall be made in the following installments:*
>
> 1. *$175,000.00 within 10 days of the entry of this Order;*
> 2. *$175,000.00 within 120 days of the entry of this Order;*
> 3. *$175,000.00 within 240 days of the entry of this Order;*
> 4. *$175,000.00 plus interest on the payments… within 365 days of the entry of this Order.[3]*

So that’s what the company’s agreed to pay. What about the individuals the SEC is blaming?

From Pyatt’s Order

> *Pyatt lacked public company or accounting experience and failed to hire executives with the required expertise.[4]*

It’s not a party til it’s a *nepotism* (and cronyism) party!

> *In May 2011, MSLP hired a new chief marketing officer (“CMO”). The CMO was a former executive and co-founder of a major customer of MSLP. Pyatt knew that the **CMO’s brother remained the CEO of the major customer**. The CMO’s brother was also a greater than 10% owner of the major customer. From May 2011 to April 2012, Pyatt did not identify the related party relationship or consider if disclosure was necessary.[4]*

> *In July 2012, MSLP hired a new CFO. Pyatt was aware that the **CFO had previously been CFO of MSLP’s major customer (where the CMO’s brother was CEO)** and acquired a 1.75% indirect interest in the major customer. The CFO also continued to perform work for the CEO of the major customer personally at no charge while he worked at MSLP.[4]*

We couldn’t make this up if we tried. It goes deeper:

Can’t pay vendors? Just give away stock without telling the SEC!

> *In 2011, MSLP lacked funds to pay approximately $1.1 million of outstanding invoices to vendors dating back to services and products purchased in 2009 and 2010.*
>
> *To pay off the vendors, MSLP entered into numerous agreements, negotiated and signed by Pyatt, with third parties who were willing **to pay MSLP’s vendors in cash in exchange for shares of MSLP stock that the third-parties immediately sold into the market…***

> *…No registration statement was filed with the Commission for these transactions and no exemption from registration was available.[4]*

Pyatt’s penalties

> *Respondent shall pay civil penalties of $150,000 to the Commission. Payment shall be made in the following installments:*
>
> 1. *$37,500.00 within 10 days of the entry of this Order;*
> 2. *$37,500.00 within 120 days of the entry of this Order;*
> 3. *$37,500.00 within 240 days of the entry of this Order;*
> 4. *$37,500.00 plus interest on the payments … within 365 days of the entry of this Order.[4]*

The good news is that to make up for the above MSLP financial shortcomings (amongst others), Pyatt has announced staffing reductions (ie layoffs) will be coming to MusclePharm.[10] That’s discussed later, though – we’re only halfway done with the SEC PDFs.

From Lawrence Meer’s Order (CFO from 2010-2012)

> ***Meer lacked public company experience*** *and failed to educate himself with the required expertise. Meer failed to ensure sufficient internal controls were enacted and proper books and records were kept.[5]*

> *Two companies owned by Meer filed for bankruptcy in 2008 in the United States District Court for the Southern District of Florida. MSLP never disclosed the bankruptcies of Meer’s former companies in Commission filings.[5]*

To make that part worse, it continues,

> *From April 2011 through October 2012, MSLP’s filings also*

> *included a misstatement that "[n]one of the members of the board of directors or other executives has been involved in any bankruptcy proceedings." Meer did not correct the misstatement or omissions in the Commission filings that he reviewed, approved, and signed.[5]*

$6.9 *million* in future sponsorship expense commitments not reported

> *MSLP **failed to disclose continuing sponsorship commitments** in its Form 10-K for the year ended December 31, 2011 and its Forms S-1 filed during 2012 as required under GAAP. The future sponsorship commitments required MSLP to make future payments totaling **$6.9 million through 2013**.[5]*

Disgorgement and civil penalties

SEC accountant no more… at least not for three years:

> *Meer is **denied the privilege** of appearing or practicing before the Commission **as an accountant**…*
>
> *…After **three years** from the date of this Order, Respondent may request that the Commission consider his reinstatement by submitting an application…*

From Gary Davis's Order (CFO from 2012-2014)

So could L. Gary Davis clean up the job? Soon after he was hired, he must have realized that he'd walked into a shit storm:

> *In July 2012, MSLP hired Davis as the CFO. Davis realized that MSLP had almost no internal controls or policies or procedures. Davis focused on maintaining MSLP's daily operations and focused on developing the accounting department by hiring additional accounting staff with CPAs[6]*

> *Beginning in November 2012, Davis began to implement travel*

> *and expense policies, which required MSLP employees to provide original receipts for their expenses.*
>
> *Davis, however, did not implement any formal policies or procedures to ensure perquisites were being properly identified and disclosed. Executives continued to submit reimbursement forms and make charges on company credit cards for personal items without providing original receipts.[6]*

Change is difficult.

> *In July 2013, Davis identified at least $100,000 of undisclosed perquisites. Despite the perquisite review not being complete, MSLP filed a Form S-1 in August 2013 with incorrect perquisite disclosures that were identical to amounts previously disclosed before the internal review began. Davis reviewed, approved, and signed the Form S-1.[6]*

> *On March 31, 2014, MSLP filed its 2013 Form 10-K, which was reviewed, approved, and signed by Davis…*
>
> *…The table also disclosed approximately $134,000 of perquisites in 2013. These disclosures, however, still understated perquisites paid to MSLP executives.[6]*

Davis's Punishment

> *Davis is **denied the privilege** of appearing or practicing before the Commission **as an accountant**…*
>
> *…After **two years** from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application…[6]*

Davis' story must be out of this world.

From Donald Prosser's Order (CPA and Board Member from 2012 – 2014)

Prosser sat on the board and attended several meetings that discussed the perquisite expenses discussed above. They hired a consultant to perform a review, but then fired that consultant. They then hired an internal auditor.

> *“Prosser assisted and supervised the work of the internal auditor and consulted with the internal auditor during the review.”[7]*

> *On April 14, 2014, Prosser resigned from the MSLP board, including as a member of the audit committee as its chair, and became MSLP’s interim CFO.[7]*

The above happened just in time for this:

> *On July 23, 2014, MSLP filed a Definitive Proxy Statement, which included the same deficient perquisite disclosure as the 2013 Form 10-K.*

Prosser’s Punishment

> *Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of* ***$30,000*** *to the Securities and Exchange Commission.[7]*

Our take

In all honesty, there are definitely supplement companies doing far “worse” things.

The difference here, though, is that nearly all other supplement companies are *privately* held, not public corporations like MusclePharm!

What the SEC auditors witnessed was essentially the aftermath of a quickly-growing public company **behaving like a privately-held one**. And that doesn’t fly with the Feds on the SEC for one second.

These guys need a babysitter

Just like Google’s board of investors hired Eric Schmidt to keep Larry Page and Sergey Brin from burning the house down,[8,9] MusclePharm clearly needs an adult in the room too.

You know, someone who would say *"Hey, maybe we **shouldn't** sponsor Johnny Manziel? Guys? Guys???"*

The company's founders obviously did a fantastic job of growing revenue, but the general rule of thumb in the startup world is that once revenues are greater than $15 million, a *real* CEO needs to step in. MSLP is leagues beyond that.

"Reducing costs will unfortunately include the elimination of some positions throughout the company"
—Brad Pyatt, August 25, 2015[10]

Even further, once a company goes public, they are now under the SEC's rule of law, which is far more complex and definitely not for rookies.

As it stood during 2010-2014, you effectively had an exponentially-growing public corporation run by an NFL athlete with a fitness model for a figurehead. This means no offense to them – especially not to Cory Gregory, who's one of the absolute best in the business at what he does.

There just simply comes a point when investors need to see some grown-ups handling the books with more power over the expenses, even if they're unathletic bean-counters with thick glasses.

Layoffs / Staff Reductions Coming

Earlier, Pyatt was quoted stating that *"Reducing costs will unfortunately include the elimination of some positions throughout the company"*[10], so there may be some layoffs or other such reductions in staff coming in short order.

Oh well, sounds like they had a fun four or five years, though! Maybe it was worth the trouble – YOLO and all that, we suppose.

Bummer for those who are about to be laid off in the wake of all of this, though – whatever's best for the corporation, the board, and the investors, right?!

Any product ramifications? Unlikely

Wreckage indeed. But it seems like business as usual for MPNation's favorite products… give or take a few pending layoffs

As customers, we doubt anyone will change their product affiliations – if you loved supplements like Assault or Amino 1 before, nothing is going to change about that.

But as *investors*, you're best to steer clear until you start seeing some seriously positive changes.

What does this mean for the future of MusclePharm? Did the shark just get jumped for one of the biggest companies in the industry?

Only time will tell. But ultimately, we still know that these guys can brand the balls off of this industry, so our long-term outlook is still positive – especially with the entire industry continuously growing and sales in Wal-Mart and Costco. But in the short-term, investors should be prepared for a few bumps in the road.

Now what?

The current SEC investigation seems to be over, but we're not sure if *The Athlete's Company* is out of this tunnel just yet. Investigative teams and auditors may continue to peel back the layers of this onion, and MSLP may have to re-file more forms, disclosing more information.

Make sure to stay tuned to PricePlow as we keep a careful eye on this story and bring you the latest developments!

And in case there are any great sales on MusclePharm supplements, be sure to sign up for price drop alerts below:

MusclePharm – Deals and Price Drop Alerts

Get Price Alerts

Get MusclePharm alerts

☐ Also get **hot deal** alerts

No spam, no scams.

Disclosure: PricePlow relies on pricing from stores with which we have a business relationship. We work hard to keep pricing current, but you may find a better offer.

Posts are sponsored in part by the retailers and/or brands listed on this page.

References

1. *US Securities and Exchange Commission; "SEC Charges Sports Nutrition Company With Failing to Properly Disclose Perks for Executives"; September 8, 2015; Retrieved from* https://www.sec.gov/news/pressrelease/2015-179.html
2. *Google Finance; MusclePharm Corporation; Retrieved from* https://www.google.com/finance?q=OTCMKTS%3AMSLP
3. *US Securities and Exchange Commission; "SEC order against MusclePharm"; September 8, 2015; Retrieved from* https://www.sec.gov/litigation/admin/2015/33-9903.pdf
4. *US Securities and Exchange Commission; "SEC order against Pyatt"; September 8, 2015; Retrieved from* https://www.sec.gov/litigation/admin/2015/33-9904.pdf
5. *US Securities and Exchange Commission; "SEC order against Meer"; September 8, 2015; Retrieved from* https://www.sec.gov/litigation/admin/2015/33-9905.pdf
6. *US Securities and Exchange Commission; "SEC order against Davis"; September 8, 2015; Retrieved from* https://www.sec.gov/litigation/admin/2015/33-9906.pdf
7. *US Securities and Exchange Commission; "SEC order against Prosser"; September 8, 2015; Retrieved from* https://www.sec.gov/litigation/admin/2015/34-75855.pdf
8. *Google Press; Google Names Dr. Eric Schmidt Chief Executive Officer; August 6, 2001; Retrieved from* https://googlepress.blogspot.com/2001/08/google-names-dr-eric-schmidt-chief.html
9. *Cyran, Robert; Google's $100 mln babysitter may be worth it; Reuters; January 24, 2011; Retrieved from* https://www.reuters.com/article/2011/01/24/idUSN2418025220110124
10. *Lubove, S; MusclePharm to Position Company for Future Profitability; via United States Securities and Exchange Commission; August 25, 2015; Retrieved from* https://www.sec.gov/Archives/edgar/data/1415684/000119312515301691/d28797dex991.htm