IPRPD
International Journal of Business & Management Studies
ISSN 2694-1430 (Print), 2694-1449 (Online)
Volume 05; Issue no 11: November, 2024
DOI: 10.56734/ijbms.v5n11a1

UNDER ARMOUR: REVENUE PULL FORWARDS AND DISCLOSURE FAILURES

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Abstract

This case examines a recent SEC settlement with Under Armour, a public company traded on the NYSE, that was charged with misleading investors and failing to disclosure uncertainties relating to its reported revenues. Under Amour was not able to meet analysts' sales projections for several consecutive quarters in 2015 and 2016 and resorted to "pulling forward" revenue from future periods in order to meet these estimates. More than $408 million was pulled forward, and during this time Under Armour continued to credit its growth to apparel, footwear and other new offerings. The case was settled in May 2021 and Under Armour paid a $9 million penalty.

The case spotlights several important accounting and ethics issues in the context of a real, multi-national company that most college students are familiar with. From an accounting perspective, the revenue pull forwards, manipulation of payment terms and omission of material facts in financial reporting are discussed. From an ethics perspective, a discussion is included on the timing of reporting "earned" revenue, the legality of inducing customers to accept early shipments and the difference between omitting information and misleading investors.

Keywords

Revenue Recognition, Revenue Pull Forwards, Disclosure Violations

1. Introduction

Under Armour is a publicly traded company headquartered in Baltimore, Maryland, that develops, markets and distributes performance apparel, footwear and accessories. The company was founded by Kevin Plank in 1996 and went public in 2005. Under Armour maintains three classes of common stock which are listed on the New York Stock Exchange (Under Armour, 2022).

Under Armour's principal business activities include developing, marketing and distributing its branded apparel, footwear and accessories. The company sells products globally to national, regional, independent and specialty wholesalers and distributers as well as directly to consumers through retail stores and e-commerce websites. Some of its best known, patented products include HEATGEAR® and COLDGEAR®, moisture wicking apparel which help regulate/maintain a user's core body temperature. During 2021, 68% of net sales were from apparel, 22% were from footwear, 8% were from accessories and the remaining 2% were from licensing arrangements (Under Armour, 2021).

The market for performance apparel, footwear and accessories is very competitive. Many of Under Amour's direct competitors are larger and have grater brand recognition (for example Nike and Adidas).

2. Revenue Pull Forwards

As a reporting company registered with the Securities and Exchange Commission, Under Armour is required to file accurate annual, current and quarterly reports under Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11 and 13a-13. From Q2 of 2010 through Q3 of 2016 (26 consecutive quarters), Under Armour reported year-over-year revenue growth in excess of 20%. These quarterly reports consistently met or exceeded analysts' revenue estimates. The Company frequently highlighted this "growth story" and referenced its revenue growth rate in public communications with investors and analysts (SEC, 2021a).

During this time, the Under Armour brand continued to gain popularity, signing famous sponsors including Tom Brady (NFL), Michael Phelps (Olympic swimmer), Stephen Curry (NBA), and Misty Copeland (American Ballet Theater). During a 2012 earnings call, CEO Kevin Plank claimed, "We are the athletic brand of this generation and the next" (Cam 2019). The stock price hit a high of $105.89 during 2015 (Under Amour, 2015).

Despite its reported growth streak, by the second half of 2015 Under Armour began to anticipate shortfalls from analysts' earnings estimates. Internal revenue and growth forecasts indicated that internal sales projections from North America were not being met, in part due to warm weather negatively affecting the sales of COLDGEAR®, the higher-priced cold weather apparel (SEC, 2021b). Senior management was concerned that missing analyst estimates would negatively impact the company's stock price. In order to meet the consensus estimates and avoid any negative stock price effects, Under Amour began to pull forward sales orders by offering incentives like discounts or extended payment terms to its wholesale customers (Michaels, 2021). A revenue pull forward commonly includes executing a customer sale earlier than originally scheduled, in this case in an earlier quarter in order to help the Company meet analysts' revenue estimates.

By the third quarter of 2015, senior management knew it was unable to meet the full-year projections for company-wide revenue. In order to close the existing revenue shortfall, the company identified existing customer orders from the fourth quarter of 2015 that could be shipped early, in the third quarter. Under Armour offered discounts and extended payment terms to persuade customers to accept the early product shipments, pulling forward $45 million in orders from the fourth quarter into the third quarter of 2015 (approximately 3.74% of its total revenue for that period). Without the revenue pull forward, Under Armour would have missed the analysts' earnings estimates.

In the fourth quarter of 2015, Under Armour was still projecting shortfalls. The declines in sales meant it would miss analysts' estimates and end its 20%-plus revenue growth streak. To avoid this, the company pulled forward $99 million in orders from Q1 of 2016 into Q4 of 2015 (approximately 8.45% of the total revenue for that period) (SEC, 2021a). During that same time, Under Armour highlighted its revenue growth on its SEC filings as well as earnings calls and press releases, maintaining, "The increase in net sales was driven primarily by apparel unit sales growth in new offerings in multiple lines led by training, golf and running; and footwear unit sales growth, led by running and basketball and the expansion of our footwear offerings internationally" (Under Armour, 2015). There was no mention of the revenue pull forwards.

The sales slowdown continued into 2016 and was exacerbated when one of Under Armour's major customers filed for bankruptcy. In July it announced a new partnership with Kohls, allowing for hundreds of new locations to stock its products (Safdar & Viswanatha, 2019).

In early 2016, Under Armour's internal revenue forecasts continued to be below analysts' estimates. The cause of these shortfalls was twofold: 1.) lagging sales in North American and 2.) the revenue pull forwards from the prior year. In order to close the revenue gap between actual and expectations, Under Armour pulled forward $17.5 million in Q1 from Q2 (about 1.67% of total revenue for that period). The company continuing pulling revenues forward in the second quarter, recognizing $10 million in orders from Q3 (about 1% of the total revenues for the quarter) (SEC, 2021a).

At the same time that sales were slowing, the amount of money that Under Armour was allocating for returns or markdowns was increasing. In 2016, revenues rose 22%, while the reserves for returns rose 55% (Safdar & Viswanatha, 2019). Senior management began to distance themselves from the Company; the chief merchandising officer and chief digital officer resigned in 2016 and the chief financial officer followed soon after (Cam 2019).

The gap between internal forecasts and external analysts' forecasts continued to grow in the third quarter of 2016. Management at Under Armour continued pressing customers to accept early shipments of products, offering more price discounting and extending payment terms. By the end of the third quarter in 2016, $65 million was in revenue was pulled forward (approximately 4.2% of total revenue for the quarter). Under Armour continued to highlight this growth streak in its earnings guidance and filings.

By the end of 2016, management was aware of a significant and increasing revenue shortfall. It was estimated that more than $160 million would need to be pulled forward in order to close the gap. Senior management was becoming increasingly concerned about the negative effects of the revenue pull forwards on future periods. After revising some of the planned pull forwards, Under Armour ultimately pulled forward $172 million in orders from Q1 of 2017 to Q4 of 2016 (approximately 13.15% of its revenues for that quarter) (SEC, 2021a). Despite the large pull forward, Under Armour was not able to meet analysts' revenue expectations, ending its 26 period growth-streak.

In total, the third quarter of 2015 through the end of 2016 (six consecutive quarters), Under Armour pulled more than $408 million in revenue forward to help it meet or beat analysts' revenue estimates (SEC, 2021a).

	Q3 2015	**Q4 2015**	**Q1 2016**	**Q2 2016**	**Q3 2016**	**Q4 2016**
Revenue Pulled Forward	45,000,000	99,000,000	17,500,000	10,000,000	65,000,000	172,000,000
Reported Sales Revenue	1,204,000,000	1,171,000,000	1,048,000,000	1,001,000,000	1,472,000,000	1,308,000,000

% of Revenue Resulting From Pull Forwards	3.74%	8.45%	1.67%	1.00%	4.42%	13.15%
Exceeded Analyst Expectation by:	$29 million	$53 million	$12 million	Met	$18 million	Did not meet

Table 1: Summary of Under Armour revenue pull forwards by quarter:

3. SEC Investigation and Aftermath

In January 2017, Under Armour announced for the first time that it missed analysts' revenue estimates for the fourth quarter of 2016 as well as the full-year 2016 estimates. As a result, the Company stock price dropped by 23%. Since January 2017, Under Armour's year-over-year growth rate been reported in the single digits or negative (SEC 2021a). Three shareholder lawsuits followed, alleging company management had misled shareholders about Under Armour's financial standing (Cam, 2019). These were consolidated into a single securities class action claiming the revenue pull forwards and related earnings disclosures were misleading and omitted material information regarding the shifting of sales between quarters. The Company also failed to disclose the investigations by the SEC and DOJ that had been ongoing since 2017 (Under Armour, 2020).

In 2019, Company founder Kevin Plank announced he was stepping down as CEO (Roberston & Creswell, 2019). On July 22 2020, Under Armour filed an 8K disclosing that it had received a Wells Notice from the SEC relating to its disclosures from the third quarter of 2015 through December 31, 2016 concerning its use of revenue pull forwards during that period. According to the 8-K, "The Company and the Executives maintain their actions were appropriate and intend to pursue the Wells Notice process, which will include the opportunity to respond to the SEC Staff's position, and also expect to engage in a dialogue with the SEC Staff to work toward a resolution of this matter" (Under Armour, 2020b).

On May 3, 2021 the SEC charged Under Armour with misleading investors about its revenue growth and failing to disclose uncertainties about its future revenue prospects. According to the SEC, "By using pull forwards for several consecutive quarters to meet analysts' revenue targets while attributing its revenue growth to other factors, Under Armour created a misleading picture of the drivers of its financial results and concealed known uncertainties concerning its business" (SEC, 2021b). Under Armour did not provide investors with material information about its sales and revenue necessary to fully understand its operations, and as a result, violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13, and 12b-20 (SEC, 2021a), which prohibit any person from directly obtaining money by means of untrue statement of a material fact (or omission of a material fact) necessary in order to make the statements not misleading.

Under Armour agreed to cease and desist from further violations and pay the SEC a $9 million civil monetary penalty. The Company did not admit or deny the findings in the SEC's administrative order but stressed in its press release that the settlement related only to the disclosures from the revenue pull forwards and not violations of generally accepted accounting principles. Under Armour also included in the announcement that the settlement resolved all outstanding SEC claims and that it had not received any requests from the DOJ since the second quarter of 2020 (Under Amour, 2021b).

4. Discussion Questions and Suggested Solutions

1. Briefly describe what happened with the revenue reporting at Under Armour

Under Armour was charged by the SEC with misleading investors and failing to disclosure uncertainties relating to its revenue projections. Under Amour was not able to meet analysts' sales projections for several consecutive quarters in 2015 and 2016 and resorted to "pulling forward" revenue from future periods in order to meet these estimates. More than $408 million was pulled forward, and during this time Under Armour continued to credit its growth to apparel, footwear and other new offerings. The case was settled in May 2021.

2. Define revenue pull forwards and explain why the practice is problematic for companies

Revenue pull forwards occur when a company convinces a customer to accept or place an order sooner than they normally would. This allows the company to record the revenue sooner and still meet the GAAP rules for revenue recognition. The practice can be used to help companies meet analyst projections that would otherwise be missed. Revenue pull forwards can be problematic since GAAP requires the disclosure of material accounting estimates for revenue recognition, so if a company fails to include this practice in filings, it can be considered a material omission. Additionally, each time revenue is pulled forward, it takes sales away from a future quarter to feed the previous one. At some point there are no more sales to pump up the current quarter.

3. ***List some of the pressures Under Armour faced that motivated management to pull revenue forward for so many periods***

- The market for performance apparel, footwear and accessories is very competitive and many of Under Amour's competitors are larger and have grater brand recognition.
- Pressure to continue its year-over-year growth streak.
- Impact of its earnings on stock price and what might happen if consistent growth is not maintained.

4. ***Is pulling revenue forward illegal, unethical or both? Provide support for your answer***

Pulling future revenues forward into a current period is not necessary illegal, but failing to disclose the practice to shareholders is. Companies usually have to offer incentives to customers (for example, price rebates, discounts, extended or favorable payment terms, etc.) to convince them to take products earlier that are not truly needed until a future quarter. Depending on the incentives and how long this process goes on for, pulling revenue forward can be seem as unethical, but it is not illegal unless the company misleads investors. There is also an ethical tradeoff to consider for current shareholders versus future shareholders – the current shareholders benefit from the accelerated revenue recognition, but at the expense of future shareholders.

5. ***Explain which part of the Securities Act Under Amour actually violated and how this is related to revenue pull forwards***

According to the settlement, Under Armour violated Section 17(a)(2) and (3) of the Securities Act, which, "…prohibit any person from directly or indirectly obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser, in the offer or sale of securities". It also found Under Armour violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 13a-13 thereunder, which require companies to file complete and accurate annual, current, and quarterly reports. The company also violated Rule 12b-20 of the Exchange Act, which required it to file a statement/report with the Commission containing any additional information necessary to make the required statements not materially misleading. There were also violations of Regulation S-K.

The SEC did not claim the accounting for sales revenue was not recorded in accordance with GAAP, it only took issue with the lack of disclosure and failure to file complete and accurate financial reports.

6. ***Explain the difference between omitting information versus misleading investors in an SEC filing***

Omitting information occurs when a company fails to disclose something to investors. Misleading investors occurs when the omission is material, which according to the SEC occurs when, "…there is substantial likelihood that a reasonable investor would attach importance (to it) in determining whether to buy or sell the securities registered." When material information is omitted in a required public filing, the company may be subject to fines, penalties and other legal action.

7. ***Describe what happened in the aftermath of the settlement:***

a. To the stock price?
The price of shares dropped after the settlement. The stock trades around $10 today.

b. To the senior leadership team?
- No individuals were charged by the SEC after the settlement.
- Company founder Kevin Plank stepped down as CEO but serves as the Executive Chair and Brand Chief on the Board of Directors.
- CFO David Bergman still serves at CFO today.

c. To Under Armour's reputation?
Other than the drop in stock price, there does not appear to be any lasting reputational damage to Under Armour as a company. According to the most recent 10-K, 2021 revenue was up 27% to $5.7 billion and operating income reached $486 million, both records for the company.

8. ***Under Armour agreed to pay $9 million to settle the SEC enforcement action. Do you think is an appropriate penalty? Explain why or why not.***

This penalty seems low, given that Under Amour pulled forward more than $408 million in sales and misled investors for more than six consecutive quarters. This type of penalty will not serve as a deterrent to future companies in a similar situation.

9. ***Many employees knew about the revenue pull forwards, but the scheme continued for six consecutive quarters.***
a. What does this say about the corporate culture at Under Amour?
b. Explain how corporate culture can affect ethical behavior.

It appears that the corporate culture at Under Amour encouraged meeting or beating analyst expectations at all costs, even when it crossed the line from unethical into illegal. This type of attitude starts at the top ("tone at the top") and has clearly not changed since the settlement, since the company founder Plank still services as the Executive Chair on the Board of Directors. The corporate culture can influence employee's behavior in either direction – towards acting unethical in order to achieve certain targets, metrics, etc. or towards more ethical behavior.

5. Learning Objectives and Implementation Guidance

5.1 Learning Objectives

The case is designed to be used in either an introductory or mid-level undergraduate accounting class. There are four main learning objectives:

1. Students will define revenue pull forwards and explain what happened at Under Armour. (Question 1, 2).
2. Students will discuss whether revenue pull forwards are illegal, unethical or both. (Question 4, 5, 9).
3. Students will consider the difference between omitting information and misleading investors. (Question 6).
4. Students will describe what motivated the revenue pull forwards and what the ultimate outcome was for the company. (Question 3, 6, 7, 8).

The discussion questions require students to provide specific responses related to what happened at Under Armour, and to consider some of the broader ethical issues at play. From an accounting perspective, students will explain the concept of revenue pull forwards and the omission of material facts in financial reporting. From an ethics perspective, students will consider the legality of inducing customers to accept early shipments and the difference between omitting information and misleading investors. Students will in engage in critical thinking as they are asked to consider the motivation of senior management at Under Armour and the role of corporate culture on ethical behavior.

5.2 Implementation Guidance

It is recommended to administer the case after some discussion of revenue recognition has taken place, as well as some discussion on how company earnings may impact stock price. The case may be given as is, or the instructor can select specific discussion questions to emphasize (or reduce) the exposure to certain concepts. For example, in an introductory accounting class, the instructor may wish to omit specifics about the Securities Act and focus on the ethical issues – omitting material facts while bragging about year over year growth.

Due to the length of the case and the potential to complete an in-depth analysis, it is suggested that the case be assigned to groups of 3-4 students. At least one full (in-person) class period (90 minutes) should be provided to work on the case so that students are given a chance to read and digest the material as well as ask the instructor any clarification questions. The case is designed to be adaptable to meet the needs of different course levels and different areas of instructor focus, thus different discussions questions and time spent on those solutions can be chosen. After the initial class period, students should be given an additional 1-2 weeks outside of class to complete the case.

Once the case is submitted, instructors should spend additional class time reviewing the solutions, particularly those requiring more critical thinking. Students take a greater interest when the topics are timely and relevant, therefore instructors should take advantage of Under Armour's name and brand recognition, which most students should be familiar with.

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