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Value investor Olstein calls for the elimination of adjusted earnings

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Are companies misleading investors on the way they report earnings?

Renowned value investor Bob Olstein thinks so. In an interview with CNBC, Olstein said earnings reports are just too complicated and misleading.

"The way companies add back stock-option expenses, the way they report non-recurring write-offs…even the way they value companies solely on EBITDA, it's misleading. I'm calling for an end to the reporting of adjusted earnings. Its GAAP or nothing because it's being abused," he said on "Street Signs." "Additional disclosure beyond GAAP reported earnings can be part of the management discussion but shouldn't be in the report. If GAAP is wrong, let's change it. The fox is guarding the chicken coop."

For Olstein, GAAP EPS (Generally Accepted Accounting Principles) is where Corporate America needs to venture back to. Yet this effort may have a long way to go, particularly when so many companies are using adjusted numbers in their reporting that often—in Olstein's view—distort what's really going on at the company.

Just look at the disparity between GAAP and adjusted earnings. According to Olstein, GAAP earnings for the S&P 500 was at $587 billion versus $730 billion on adjusted in 2007. In 2008, the same deal—GAAP came in at $132 billion versus adjusted earnings of $436 billion. Even in 2012, the disparity was approximately $140 billion and Olstein said "that's just too large."

What's even more interesting, the way companies report and break down expenses is getting ever more intricate. Olstein highlighted a report from a major publisher last year where they added back to GAAP earnings a long list of items including work force restructuring, transformation costs, pension settlement charges, costs related to a change in control and sale of interest in the business, charges for accelerated depreciation, and the list goes on.

"How many quarters of non-recurring expenses as this—should be looked as recurring?" Olstein questioned.

Outside of write downs, one of Olstein's biggest concerns is stock-option expenses.

"The way companies treat options expenses is outrageous. The ability to add back option expenses to GAAP earnings gives a false picture. It's one of the largest abuses ever," Olstein said. "Just look at LinkedIn. If you took their adjusted EPS for FY Dec. 2013 of $1.61—take out $1.28 of stock-based compensation expense, that leaves you with $0.33 in GAAP earnings and that is a more realistic number," Olstein remarked. "If options are not a real expense, why is everyone accepting that as compensation?"

In the end, Olstein's real fight on the earnings front may lie with regulators where Regulation G allows non-GAAP financial measures as long as it does not mislead the public. In 2011, the SEC targeted Groupon—saying its reports were misleading over its add-back of online marketing expenses. That was three years ago and just one of a few companies in Corporate America.

Olstein is calling for immediate change so the public is not misled.

—By CNBC's Donna Burton
