

Large company accounts are works of fiction

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In this morning's video, I argue that the accounts of the largest companies in the UK and around the world are works of fiction because no company in existence has undertaken the transactions that they record. I ask, is that what we really need when we come to assess what the private sector is up to?

<https://www.youtube.com/watch?v=ubIQ3n0SIRw>

The audio version is here:

https://www.podbean.com/player-v2/?i=q57re-16a1f3f-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=60a0c8&font-color=&logo_link=episode_page&btn-skin=ff6d00

A ChatGPT-generated summary of the argument is:

The largest companies' accounts are fictional, misrepresenting reality.

Consolidated accounts mask internal trades and risks, hiding tax abuse and environmental impacts. This compromises creditors and public transparency, as subsidiary details remain concealed.

A better approach, like country-by-country reporting, could provide clearer insights into these companies' activities and risks globally.

The transcript is:

The accounts of the largest companies in the UK and around the world are works of

fiction. I seriously mean that.

They are make believe. Made up. They are not representative of any truth that has actually happened. And that's a very serious allegation to lay against the accounting professions of the world, and all the companies that produce these accounts. But I'll stick by that opinion. I believe that some of these accounts should be entered for a literary prize because they are so abstracted from reality, just as fiction is.

Let me explain what I mean by all this.

If you pick up the accounts of a very large company, call it a public limited company in the UK - one of those quoted on the stock exchange - you will find a document which, if it is in printed format, will be hundreds of pages long. Some are 400-plus pages. But there is no company that ever undertook the transactions that are reported in those accounts. There is quite simply nothing like that company that issues that report anywhere in the world. Hence my allegation that these are a work of fiction.

The company that issues the report will be the parent company of the group with the name printed on the front cover. But that parent company very rarely trades with anyone. It owns a myriad of other companies that form the group that go to make up the organisation which is given the name of the parent company. It is those subsidiary companies owned and controlled by the parent company that actually trade.

So, if you go into a retail store owned by a quoted company, the store will be managed by some other company and not the parent entity.

That store will be supplied by a supply chain company owned by the parent entity, but different from the store itself.

There will also be an in-house insurance company.

There will also be an in-house bank, in all likelihood.

And there will be many companies to operate stores in many countries.

This group will expand incredibly rapidly if it does a bit of merger and acquisition activity, and very few quoted companies seem able to resist the idea of doing that as a way to achieve growth. Then they will acquire a few hundred other companies every time they acquire another group.

All of those companies will probably survive because nobody can remember why they were created. And therefore, rather like in a game of Jenga, they'll be too frightened to pull one of the blocks out of the whole edifice of companies that makes up the whole just in case, pulling that particular block out, for reasons that nobody understands, pushes the whole thing over. So, these things grow like Topsy.

Accountants get round this, by producing what are called consolidated accounts. It's a set of consolidated accounts that form that published document that I referred to at the start of this video. Consolidated accounts presume that all those companies that are under common control are one company.

But it is an assumption. It's not a fact. It's not a truth. It is literally a myth created by the accountants for their own convenience. There is no one such company. But they pretend there is, just as the novelist pretends that the world they write about exists.

And in this pretense to produce this set of consolidated accounts, all the trading between those companies under common control is removed from view. They literally eliminate it. But that's really, really important. Because, for example, almost all the tax abuse undertaken by almost all companies in the world takes place within those transactions between companies within the group because that's how they shift profits from high tax jurisdictions to low tax jurisdictions, for example.

And that's also how they shift manufacturing from jurisdictions with high environmental regulation to jurisdictions with low environmental regulation, for example.

So, we should know what is happening inside a group, but those accounts remove it from view.

Even more, they remove all the balances between those companies from the balance sheet. So we don't know whether a company within that group, within one particular country, might be at risk of failure because it is actually looking decidedly financially dodgy, even though the group as a whole is looking fine.

And the creditors of that one company in that one country might not even be able to find out for themselves. Looking at the parent company accounts will tell them nothing about what is going on in their particular domain with that particular company. So, the creditors of the company are put at risk by this approach.

And that's quite important because if you go back into the history of accounting, the main reason for the creation of accounts was to protect the creditors of the company from abuse by the directors of the company itself. And now we have the company itself putting out sets of accounts that don't even reflect the accounts of every subsidiary company, which accounts might also not be available on public record, anywhere in the world.

Now, all of this worries me because the use of limited liability is a privilege. Society lets companies have limited liability because there is obvious evidence that the accumulation of capital under common control can be a benefit. It can also, and let's be honest about this, be a threat. Monopoly is one of the consequences. But let's assume that the benefits overall outweigh the costs and therefore the provision of limited liability is worthwhile.

But those who might be prejudiced by the use of limited liability need to be protected. And if the set of accounts that they're given for the group as a whole does not explain how they are at risk then that set of accounts fails to meet the needs of those users.

Most of us are in some way or other amongst those users. We trade with these companies, whether we know it or not. We might place deposits with them, which are at risk. If we are ourselves in business, we might find it difficult to work out what risk we face by trading with this entity. And if we have a pension, and we invest in this company, we might not understand the full measure of the risk inside the company in which our pension funds place its funds because its accounts are, as I suggest, a bit of a work of fiction - a decidedly narrow choice of perspective on what is going on inside the world of that entity.

There are other choices available. For example, they could produce what are called country-by-country reporting accounts. It is a method of accounting which, I admit, I created, but it is now the law in 80 countries around the world because the OECD adopted it in 2015 for tax reporting purposes. Those accounts could be put on public record.

We could find out what multinational companies are doing in every country in which they operate as a result.

And we would learn a great deal more about intra-group trading between companies within the group as a consequence as well, because that system is designed to show that.

My point is, we have a system of accounting that is chosen to hide the true perspective of what is going on inside most of the world's largest companies from view. I don't believe that that is an acceptable risk now that they hold so much power in this world.

Accounting needs to rise to the challenge of meeting the needs of all the users of accounts in all the places that they are, whatever their need might be, and it isn't doing that. And as a result, it's failing us all, and it is not producing the public good in the form of a set of accounts that meet the need of users that it should be. And that's not good enough.