

PwC's response to the Report on Auditor Clauses in Loan Agreements

- 1 This paper sets out PwC's response to the Report prepared for the Competition Commission (CC) by Cardiff Business School on Auditor Clauses in Loan Agreements (the **Report**).
- 2 Our view, as set out in paragraphs 14 to 16 of the Annex to our response to the CC's framework working paper on Restrictions on Entry or Expansion, is that any mandatory requirement in loan agreements that the borrower should appoint certain audit firms only, in all situations, is inappropriate.
- 3 However, from the findings in the Report, it appears that no such requirements exist to any material degree for large companies in the FTSE 350. In particular, auditor identity clauses, while common in US loan agreements¹, are not common in UK loan agreements².
- 4 The most widely used loan documentation for the UK is that produced by the Loan Market Association (**LMA**). According to the Report, only one set of their documentation (the Leveraged Loan documentation) contains a "Big Four clause", in which auditors are defined as one of the four largest firms. However, even where it appears, the clause is presented so that it is capable of being amended or removed - including through the use of square brackets and specific guidance in the Users' Guides.³ As a result, even in cases where the clause is present it is clearly not mandatory.
- 5 Furthermore, based on the findings in the Report, few FTSE 350 companies would use loan agreements based on the LMA Leveraged Loan documentation in any case, because they are appropriate where credit quality is low.⁴
- 6 To the extent that LMA Leveraged Loan documentation is used by FTSE 350 companies, and the Big 4 clause is left in the agreement, there are a number of possible reasons for this, including the legitimate concern of the lender(s) in question that the borrowing entity should be audited by a firm that is known to provide reliable and high quality audits.⁵ Given that the quality of the accounting information will have financial implications for the lenders in these situations it is entirely understandable that they might seek to require the borrower to appoint an audit firm that has a track record of providing audits to large, complex companies. The borrower is of course free to resist any such stipulation. In any event, it does not seem that there is any requirement for a change of auditor to take place to satisfy such a clause, and there appears to be flexibility over the definition of auditor in appropriate cases, such as those involving mid-market borrowers.⁶

¹ Paragraph 14.
² Paragraph 20.
³ Paragraph 21.
⁴ Paragraphs 22 and 59.
⁵ Paragraph 61.
⁶ Paragraph 29.

- 7 The overall position as stated in the Report appears to be that auditor clauses are rarely included in loan agreements relating to FTSE 350 companies or others with strong credit ratings. To the extent that such a clause is present, there is considerable practical freedom to amend it to suit the circumstances of the case. This includes potentially extending the clause to include auditors outside the four largest firms should the company and/or the lender(s) consider it necessary or appropriate.⁷ In such circumstances, we do not believe that these clauses comprise any material barrier to entry for mid-tier firms to the market for the audit of FTSE 350 companies.

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15 October 2012

⁷ See paragraph 30, where four examples are cited of the LMA auditor clause being adapted to include auditors outside the Big Four.