Part III, A: Statements of sufficiency of working capital in capital markets transactions

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This document forms part of TECH 04/20CFF Guidance for preparers of prospective financial information.

Part III, A: Statements of sufficiency of working capital in capital markets transactions

1. INTRODUCTION

1. This application note applies to working capital statements required by regulation to be included in an investment circular (and to the supporting unpublished PFI, which forms the basis for the statement). This application note should be considered and read together with Parts I and II of the guidance.

2. REGULATORY REQUIREMENTS

2.1 Overview of regulation

2. Capital markets regulation in many regimes requires that the investment circular issued in connection with a transaction contains a statement by the issuer, or in some regimes the directors of the issuer, that working capital is sufficient for the present requirements of the issuer (and its group where the issuer has subsidiaries) or, if not (where the regulation applicable to the transaction permits), how it is proposed to provide the additional working capital needed. Many regulators permit only two forms of working capital statement – either the issuer states that it has sufficient working capital (a clean statement) or that it does not (a qualified statement). The form and content of the statement is typically set by regulation.

3. Examples of such regimes and regulatory requirements, which include the UK and the member countries of the European Union, are set out in Annex A.

2.2 Definition of working capital and present requirements

4. For the purpose of working capital statements, working capital is considered to be an issuer's ability to access cash and other available liquid resources to meet its liabilities as they fall due. Present requirements are generally considered to be a minimum of 12 months from the date of the investment circular, although some regulation requires a minimum of 12 months from the date of admission of shares to trading. The term used for the purpose of this application note is 'present requirement period'.

2.3 PFI in relation to working capital statements

5. Working capital statements published in an investment circular, while still PFI, are unusual because they are qualitative in nature. However, the underlying unpublished PFI, including financial forecasts/projections which support and form the basis for the statement, is quantitative in nature. The unpublished PFI is referred to as 'working capital projections' in this application note.

2.4 ESMA Guidance

6. ESMA Guidance (as defined in the Glossary) provides guidance on the requirements for working capital statements in EU prospectuses, which may also be pertinent for other regimes. In particular, the ESMA Guidance:

- requires that the working capital statement is based on robust procedures to limit the risk that the statement is called into question;
- requires the statement to be unambiguous;
- clarifies that where an issuer can state without qualifying wording that it has sufficient working capital to meet its present requirements, then a clean statement should be made. If an issuer cannot make such statement without qualifying wording, it should provide a qualified statement;

- requires that where a qualified statement is made, matters relating to the relative timing, shortfall, action plan and implications be disclosed to ensure that investors are fully informed.

7. These guidelines are in substance consistent with the guidance of other regulators, including, for example, those set out in Annex A.

2.5 Directors' accountability, including satisfying regulatory obligations

8. The directors make and are responsible for the working capital statement and should be fully engaged in the preparation process. This includes approving the working capital statement, the supporting working capital projections and considering and making decisions in relation to the need for sufficient debt facilities or other external funding. Capital markets regulation imposes overall requirements on the content of information included in investment circulars, and on the standards of care to be adopted by the directors in preparing such information. Such UK and EU regulatory obligations that apply to working capital statements are set out in Annex A.
9. While the obligations in the various regulations are articulated differently, the spirit of the obligations and standards of care are broadly aligned. They require that the process and procedures adopted by the directors are robust and appropriate such that there is very little risk that the basis of the working capital statement is subsequently called into question. They should also ensure that information included in the investment circular, as a whole, is consistent and not misleading.
10. In making a clean working capital statement, the onus is on the directors to be of the opinion that the issuer (and its group, if applicable) can access sufficient cash and other available liquid resources such that it can meet its liabilities as they fall due during the present requirement period. This guidance sets out principles and processes for the preparation of working capital statements and the supporting PFI, which help the directors to satisfy this obligation.
11. This guidance does not address legal obligations and directors should obtain legal and professional advice where appropriate.

3. APPLYING ATTRIBUTES AND PRINCIPLES TO WORKING CAPITAL STATEMENTS

3.1 'Relevant' attribute and 'user needs' principle

12. The working capital statement should address the purpose for which it is being prepared, and be prepared in accordance with the applicable regulation and guidance. For example:
    - for an issuer that has subsidiary undertakings and is making a statement that relates to the company and its group, the working capital statement should be prepared on a consolidated basis covering the entire group;
    - certain regulation requires that the working capital statement is prepared on the basis that the transaction that is the subject of the investment circular (eg, acquisition, disposal, refinancing/ reconstruction, purchase of own shares, rights issue, placing etc.) has been completed.

3.2 'Reliable' attribute and 'business analysis' principle

13. If there were significant uncertainties attached to a clean working capital statement, then the principles established in Part I would require that there be appropriate disclosure of assumptions, explanation of the underlying uncertainties and analysis of the consequences of the assumptions not being borne out in practice. However, since many regulatory regimes (including the FCA and ESMA Guidance) do not permit disclosure of assumptions in relation to a clean working capital

statement, then when a clean statement is made there should not be any significant uncertainties that would affect the validity of the statement.

3.2.1 Sensitivity analysis – reasonable worst-case scenario

14. To help limit the risk that the basis of the working capital statement is subsequently called into question, the directors should undertake sensitivity analysis to consider what they believe to be the reasonable worst-case scenario. Although reasonable worst-case scenario is a term used by regulators such as ESMA, it has not been defined or prescribed. What constitutes a reasonable worst-case scenario is a matter of judgement based on the specific circumstances: it represents what the directors judge to be reasonably possible downside sensitivities and may include mitigating actions within the directors' control. The analysis should focus on those assumptions believed by the directors to be subject to the greatest uncertainty (and where the range of possible assumed values is wide) and those assumptions that, if changed by a relatively small amount, can have a large impact on the forecast outcome. The sensitivity analysis can also be used to assess the extent to which working capital is sensitive to other assumptions. See the illustrative practical considerations and techniques in section 4.1.
15. Where, in considering the reasonable worst-case scenario, the directors conclude that there is insufficient margin or 'headroom' between required and available funding to cover such a scenario (or that a breach of covenants is projected), it will not be possible to make a clean working capital statement. In these circumstances, the directors will either need to reconsider their business plans, arrange additional financing or consider whether they should issue a qualified working capital statement – see section 3.3 on understandability.

3.2.2 Other aspects of reliability

16. The concept of neutrality is relevant to working capital statements in that directors should consider any statement required by the applicable regulation in a wider context. For example, if the statement was valid for the present requirement period but difficulties were foreseen in the subsequent period, the information might be seen as biased and the lack of disclosure misleading. In these circumstances, the directors should consider if supplementary disclosures in other parts of the investment circular would be appropriate to describe the difficulties foreseen in periods beyond the present requirement period. In considering this issue, the directors should consider the unpublished PFI that supports the working capital statement beyond the present requirement period covered by the statement.
17. The directors should also consider the availability of committed financing facilities and compliance with any covenants or material adverse change clauses. Where required by regulation or local market practice, liquidity headroom should only take into account facilities for the forecast period to the extent that they are committed. In assessing whether a facility is committed, any clauses in the facility agreements that are within the issuer's control but are forecast to be breached (whether under the base case and/or the reasonable worst case), including those, for example, relating to a change of control or covenants, should be considered.

3.3 'Understandable' attribute and 'reasonable disclosure' principle

18. When making a working capital statement (the form of which is typically set by regulation), issuers should ensure that the statement or explanation is understandable; ie, the working capital statement should be clear and unambiguous leaving no doubt in the user's mind as to whether, in the issuer's opinion, there is, or is not, sufficient working capital. The working capital statement

also needs to be understandable in the context of the overall investment circular so care should be taken to ensure that there is alignment of information within the investment circular.

3.3.1 Form of the working capital statement

19. Regulation typically requires that the working capital statement must be brief (in the case of a clean statement), track the wording of the applicable regulation, and be unencumbered by additional disclosures of risks and uncertainties even though it relates to the future. Both ESMA and the FCA, for example, consider that such disclosure of assumptions, sensitivities, or risk factors only serves to qualify and confuse the statement for shareholders and investors and, hence, they are not permitted in a clean working capital statement. However, the market practice of disclosing the basis upon which the statement is made eg, 'taking into account existing bank facilities' (provided they are contractually committed) or 'taking into account the proceeds of the issue' (provided they are firmly underwritten), is acceptable in many regimes, including, for example, by the ESMA Guidance and the FCA.

3.3.2 Risk factors

20. The typical contents of an investment circular have evolved to include greater disclosure of risk factors affecting the issuer. While the ESMA Guidance and the FCA require that these risk factors should not constitute qualifications to the working capital statement, these expanded disclosures provide useful context for the basis upon which the rest of the investment circular, including the working capital statement, is prepared. It is therefore important that the PFI underpinning the working capital statement includes sufficient consideration of the potential impact of the issuer's principal risk factors and that the working capital statement is consistent with this and other parts of the investment circular.

3.3.3 Qualified working capital statements

21. Where the directors consider that the issuer does not have sufficient working capital and it is not possible to arrange additional financing before the issue of the relevant investment circular, then (provided a clean statement is not an eligibility requirement for listing or admission) a qualified working capital statement must be made. Regulation or guidance issued by regulators typically specifies the additional matters that need to be disclosed in such cases.
22. The plans to address the working capital shortfall should be specific – not just a high-level statement of intention.

3.3.4 Alignment and interaction with disclosures elsewhere in the investment circular

23. Disclosures elsewhere in the investment circular should be aligned and consistent with the working capital statement (and vice versa). If they are not, then this would raise questions about the reliability of the working capital statement. There is particular potential for overlap between the business analysis, reason for offer, use of proceeds, and risk factor sections of an investment circular, and the working capital statement. For example:
    - if the business analysis section refers to expansion plans then the working capital assessment undertaken by the directors should show that working capital is sufficient over the present requirement period for such expansion opportunities;

- if the use of proceeds section of the investment circular states that the proceeds will be used for capital projects, then the working capital projections underlying the working capital statement need to be consistent with this;
- a risk factor such as a risk that scheduled debt repayments within the present requirement period may be missed if the business is not generating sufficient cash, is fundamentally inconsistent with a statement that working capital is sufficient;
- a risk factor that covenants attaching to facilities may limit expansion or acquisition opportunities is not necessarily inconsistent with an unqualified working capital statement. However, in the instance of a fundraising where the use of proceeds states that the fundraising is for capital projects, it would be inconsistent if an unqualified working capital statement can only be made if capital projects are not undertaken, as this would not be aligned with the use of proceeds section; and
- risk factors that are generically and broadly drafted to seek to cover all conceivable risks irrespective of materiality can start to stray into areas that potentially conflict with the working capital statement.

24. Notably, the ESMA Guidance and the guidance issued by the FCA (see Annex A) recognise this potential for overlap. The FCA has consequently stated that where a clean working capital statement is made it will pay close attention to risk factors that suggest that the issuer will or may run out of working capital in the present requirement period.

3.4 'Comparable' attribute and 'subsequent validation' principle

25. For PFI to be comparable it should be capable of subsequent validation by comparison with the outcomes in the form of historical financial information and, hence, the PFI supporting the working capital statement should be prepared on a consistent basis with historical financial information.

26. The principle of subsequent validation should not be interpreted too literally or narrowly in the context of working capital statements. Under this guidance a working capital statement is an example of PFI that satisfies the subsequent validation principle and is clearly capable of being reported against. A clean statement is that the working capital available to an entity is sufficient for its present requirements. While companies do not explicitly report actual performance against a working capital statement, it will be apparent if a company has run out of working capital. Even before a company runs out of working capital, if it is in imminent danger of exceeding its working capital facilities, this will need to be considered for disclosure in the context of the general regulatory disclosure obligations that apply to the issuer (see Annex A).

4. PREPARING PFI IN CONNECTION WITH WORKING CAPITAL STATEMENTS (AND THE SUPPORTING UNPUBLISHED PFI)

27. Part II identifies core procedures for the preparation of PFI, in the form of illustrative practical considerations and techniques, which are applicable to the preparation of all PFI. These should be applied as appropriate, in the context of a working capital statement along with those in section 4.1, which are specific to working capital statements.

28. Directors should assess those procedures that are likely to be relevant having regard to the size, complexity, predictability, and particular circumstances of the group, the industry, the general economic environment and the transaction that is the subject of the investment circular. For example, the level of detail and analysis needed for a debt-free investment entity with no committed capital or investment expenditure undertaking a fundraising will be less than that required for a complex or highly leveraged trading group facing its most important trading period.

The procedures are not exhaustive or prescriptive: other considerations and techniques may be applicable.

4.1 Illustrative practical considerations and techniques specifically applicable to working capital statements

29. The applicable practical procedures and considerations set out in Part II should be undertaken in addition to the following, which are specific to working capital statements and the supporting unpublished PFI (referred to in this note as working capital projections).

PLANNING

Board input and involvement

a. The directors are responsible for the working capital statement and should be involved and provide oversight throughout the preparation process including: planning, approving the working capital statement, the supporting working capital projections and the accompanying board memorandum or paper, and considering and making decisions in relation to the need for sufficient debt facilities, other external funding or working capital facilities.

Timely planning

b. The process should be planned in detail at the outset to ensure that sufficient time and resources are built into the project plan. In the case of an acquisition, for example, this will entail consideration of the practical issues involved in obtaining access to target information.

Applicable regulation

c. The applicable regulation and guidance should be reviewed at the outset and then followed. The directors should ensure that the working capital statement and supporting unpublished PFI that forms the basis for the statement are prepared in accordance with the applicable regulatory requirements and guidance.

Engagement with advisers

d. Where a public report or confirmation to a regulator is required from a third party (such as a sponsor/nominated adviser or reporting accountant), then such advisers should be engaged early in the process to enable appropriate involvement and for this to be factored into the directors' planning process for the preparation of the PFI.

Level of detail required in the working capital projections

e. The level of detail within the working capital projections may vary depending on the circumstances of their preparation and the level of bank balances, liquid assets, credit facilities and headroom available to the issuer.

f. Where headroom is significant and projected working capital requirements are not volatile, the level of detail required in the working capital projections may be less than in circumstances where headroom is limited and the projected working capital requirements are highly sensitive to small changes in key assumptions.

Period covered by the working capital projections

g. Notwithstanding the 12-month present requirement period of the working capital statement, it will be necessary for the directors to consider any foreseeable working capital difficulties beyond the 12-month period of the required statement and they should consequently prepare their working capital projections to cover at least the next 18 months (although it may be appropriate for the period to terminate at the issuer's next reporting date following that date).

h. If, however, the issuer's normal business cycle is greater than 18 months or the cash flow figures show an adverse trend at the end of the period which is projected to continue, then it will be necessary for the directors to address any factors likely to pose a significant threat to the sufficiency of working capital thereafter (for example, substantial repayments of borrowings, deadlines for repayment of significant loans, continuing trading losses or other factors of which the directors are aware).

i. Where relevant, the financial adviser may also have a view in relation to the period to be covered.

Frequency of balance sheets in the working capital projections

j. The frequency of balance sheets in the working capital projections will depend on the impact of seasonality, the profile and nature of trading cash flows, and covenants set by lenders, but a monthly basis is considered best practice.

k. Where cash requirements fluctuate considerably, for example due to the seasonal nature of the business, the balances may need to be considered more frequently including on an intra-month basis as set out below.

Working capital for a group proposing a major acquisition – liaising with target

l. The preparation of working capital projections for a group proposing a major acquisition may entail practical difficulties.

m. While the directors of the acquiring company will be able to assess the working capital needs of their own group, they will need to factor information relating to the potential working capital requirements of the target business into their enlarged group working capital projections. Unless the target business is already well known to the acquirer, the latter is likely to need to obtain some of this information from target management.

n. While target management can be expected to have a detailed understanding of the existing requirements of the target business, they will not be in a position to take into account the consequences of the change of ownership (for example, on the availability of funding, the extent of intra-group trading, and the trading strategy) which will be matters that the acquirer will need to address in preparing the enlarged group working capital projections.

Working capital for credit institutions and insurance companies

o. Regulatory capital or 'solvency' requirements will be an aspect of, but not identical to, sufficiency of working capital and will need to be considered.

p. Specific regulatory guidance applicable to credit institutions and insurance companies, such as that provided by ESMA, should be followed.

Qualified working capital statement – action plans and disclosure

q. If it is envisaged that the business has insufficient working capital and it will not be possible to arrange additional financing before the issue of the relevant investment circular, a qualified working capital statement (if permitted by applicable regulation) will need to be made. Proposals for securing the additional working capital need to be fully explained through disclosure. Early consultation with advisers is encouraged.

EXECUTION

Working capital projections should be prepared on a consistent basis

a. The working capital projections should be prepared on a consistent basis with the issuer's historical financial information and in accordance with stated accounting policies insofar as they are material to the working capital statement and its purpose.

Working capital projections should be prepared on a consolidated basis

b. Where the issuer has subsidiary and other undertakings, the working capital projections should be prepared on a consolidated basis covering the entire group throughout the working capital period and taking into account the financing arrangements in place across the group.

c. Restrictions on the ability to remit funds between subsidiaries (due, for example, to exchange control restrictions or the terms imposed by lenders) need to be taken into account in preparing the consolidated working capital projections.

d. Material cash flows with associated undertakings and any off-balance sheet financing vehicles should also form part of the information that the directors should analyse and appraise.

e. The applicable regulation may require that the working capital projections cover both the consolidated position of the existing group and the group as enlarged by a proposed acquisition – see below.

Working capital projections prepared on the basis that the transaction has occurred

f. Certain regulation requires that the working capital statement and the underlying working capital projections be prepared on the basis that the transaction (eg, acquisition, disposal, refinancing/reconstruction, purchase of own shares, rights issues, placings) has taken place (provided, in the case of a fundraising, that the proceeds are fully underwritten – ie, an underwriter has agreed to purchase the remaining securities that are not taken up by investors). In the case of an EU prospectus, the working capital statement needs to address all outcomes (ie, if the transaction or fundraising happens or not).

g. In relation to a reverse takeover, the statement will need to take into consideration the enlarged group, and if the transaction also involves a fundraising that would proceed even if the reverse acquisition did not take place or involves a share issue, a statement covering the existing group is also required to ensure that information on all possible scenarios is provided to users.

h. Where permitted by regulation, account is taken of offer proceeds (but only to the extent underwritten), placing proceeds (but only to the extent firmly committed) and disposal proceeds. Their treatment in the working capital projections should be consistent with references to the use of such proceeds elsewhere in the investment circular.

i. All relevant costs including transaction costs should also be factored into the working capital projections.

Consistency with historical financial information and accounting policies

j. The working capital projections should be prepared on a consistent basis with the issuer's historical financial information and in accordance with stated accounting policies to the extent that they are material to the working capital statement and its purpose.

Opening cash and loan balances

k. The opening balance sheet in the working capital projections should be supported by an actual balance sheet (and if not audited, the opening cash and loan balances should be supported by a bank reconciliation, and lender statements/confirmations).

Other forecast information/regulatory requirements

l. The directors should consider other forms of forecast information that directly contribute to the issuer's ability to maintain sufficient working capital. These may be industry specific requirements, for example liquidity considerations and regulatory capital requirements that must be complied with by certain financial services institutions as noted above.

Borrowing facilities

m. The directors should prepare an analysis of the sources of borrowings which they believe will be available over the working capital period, the amounts involved and the periods of availability (borrowing facilities).

n. The directors should undertake an analysis of the terms and conditions relating to borrowing facilities so that risks relating to continued availability of the borrowing facilities can be assessed and addressed including, for example, determining if borrowings are linked to specific projects or purposes such that, even if committed, they cannot be used for general working capital requirements.

o. The availability of borrowing facilities may be dependent upon the issuer's compliance with specific terms and conditions (covenants) and may also depend on the lender's assessment of the transaction and risks impacting security and repayment of borrowing.

p. The working capital projections should appropriately reflect these analyses, the key financial terms of the banking/loan facilities and where required by regulation or local market practice should reflect only committed funding facilities. Where required by regulation or local market practice, liquidity headroom should only take into account facilities for the period to the extent that they are committed. In assessing whether a facility is committed, any clauses in the facility agreements that may be breached, including those relating to covenants and change of control clauses, should be considered.

q. UK market practice is that 'committed' facilities are those that are in place in the present requirement period, which cannot be withdrawn or reduced (subject to normal explicit conditions such as covenant compliance) and do not need to be renewed. An overdraft facility, if it can be withdrawn at the lender's discretion, is not considered to be a committed facility.

Other sources of finance

r. The directors should prepare an analysis of other sources of funding (for example, the proceeds of a share offering).

s. The level of confidence in other sources of finance should be considered. The proceeds of an offering should only be included in the working capital projections if the offering is underwritten on a firm commitment basis or if irrevocable undertakings have been given for placings.

t. Where the transaction that is the subject of the investment circular is conditional upon the issuer achieving a specified amount of net proceeds from an offer of securities, then consideration should also be given to any minimum level of net proceeds stated in the investment circular.

Borrowing limits and covenants

u. The working capital projections should demonstrate that borrowing limits and covenants as defined under the Articles of Association, Debenture Trusts Deed, or borrowing facilities etc. will not be breached with regard to:

- projected borrowings;
- maximum utilisation of facilities; and
- covenant tests.

v. Consideration should be given to any cross default provisions in borrowing facilities which could result in a default on one bank facility triggering an automatic default on all other facilities held by the same lender.

w. In calculating projected financial covenant positions, the directors should ensure that all requirements of the facility agreements are met – eg, calculating the covenants using the exact definitions included in the agreements and taking into account related clauses such as the application of frozen GAAP or different foreign exchange rates compared to the underlying working capital projections.

Intra-month cash flows

x. Consideration should be given to whether cash/borrowings at the month-end as shown in the working capital projections are representative of cash/borrowings during the month. If working capital requirements peak during the month, consideration should be given to the extent of this additional cash requirement.

Risk factors

y. Consideration should be given to the risk factors impacting the group (including those set out in the investment circular) and their impact on the working capital projections. The risk factors should be appropriately addressed in the working capital projections.

Reasonable worst-case scenario

z. In order for the working capital statement to be made with a high degree of confidence, the directors should assess whether there is sufficient margin or headroom to cover a reasonable worst-case scenario (ie, applying sensitivity analysis) to be confident that, in the event that such a reasonable worst-case scenario unfolds in the working capital projections period, the working capital statement will still hold true. The 'base case' working capital projections should, therefore, be sensitised to reflect a reasonable worst-case scenario and to determine the impact on working capital. Although reasonable worst-case scenario is a term used by regulators such as ESMA, it has not been defined or prescribed. What constitutes a reasonable worst-case scenario is a matter of judgement based on the specific circumstances. It represents what the directors judge to be reasonably possible sensitivities. It is not a stress test (in the sense used by the financial services industry to establish an organisation's resilience to shock events), nor is it intended to be a disaster scenario. However it should be a downside analysis of the factors (singular or multiple) which have more than a remote possibility of occurring.

This will require:

- assessment of all relevant business, operational, industry specific and macroeconomic risks to the working capital projections, including the likelihood, timing and extent to which those risks might crystallise; and
- quantification of the estimated financial impact of those risks crystallising.

aa. The resulting reasonable worst-case scenario will constitute separate PFI, which will also be relied upon by the directors in making their working capital statement. It will reflect the directors' view of a reasonable worst case, rather than the most likely outcome, and should otherwise adopt the same principles of preparation as the base case working capital projections.

bb. As with the base case working capital projections, the extent of the analysis should be proportionate to the size, complexity, particular circumstances of the issuer and the risks it faces.

cc. It may, depending upon the facts and circumstances, be appropriate to test the impact of changes such as the following:

- revenue shortfall (volume and/or price);
- reliance on key customers or suppliers;
- a customer or supplier failing;
- higher than expected bad debts;
- decrease in margin/increase in raw material or labour costs;
- increase in various categories of overheads;
- changes in debtor or creditor payment profiles;
- delays in cash inflows;
- changes in regulation;
- taxation rates;
- interest rates;
- exchange rates; and
- a planned acquisition or disposal not taking place.

dd. Typically, it will only be appropriate to take account of mitigating factors or corresponding upsides to offset the downside sensitivity analysis, where the mitigation/'upside' is reasonably certain and within the directors' control.

ee. Any expected time lag between the crystallisation of the vulnerability and the implementation of the mitigating action should be addressed. It should also be recognised that certain mitigating factors/upsides may result in a short-term cash flow drain.

Other disclosures in the investment circular (eg, risk factors, business analysis, reason for the offer, use of proceeds sections)

ff. Consideration should be given to the disclosures elsewhere in the investment circular and their impact on the working capital projections and working capital statement. There should be consistency between the disclosures elsewhere in the investment circular (risk factors, business analysis, reason for the offer, use of proceeds sections and dividend policy disclosures etc.)

and the working capital statement and the working capital projections. For example, capital investment and expansion plans or opportunities referred to in the investment circular should be appropriately reflected in the working capital projections. If such opportunities are constrained by a lack of available working capital, then this should be stated in the business analysis section of the investment circular.

Impact of funding of longer-term commitments and contingencies (ie, beyond the present requirement period)

gg. The funding of longer-term commitments of a significant or potentially significant nature such as taxation liabilities, special pension scheme contributions, capital expenditure, potential damages or costs in legal disputes, and other commitments should be considered.

hh. If there is substantial doubt as to the ability of the issuer to fund such commitments that fall due after the period covered by the working capital statement, the investment circular will need to report this clearly.

Working capital difficulties in the subsequent period

ii. The working capital projections should cover a period of at least 18 months to enable consideration of working capital difficulties beyond the present requirement period. Where the directors foresee such working capital difficulties, they should consider if supplementary disclosures in other parts of the investment circular would be appropriate.

Qualified working capital statement

jj. Where the directors have determined that the business does not have sufficient working capital for its present requirements then (where permitted by the regulation governing the transaction/investment circular) a plan to address the shortfall should be prepared covering:

- the estimated quantum of the shortfall;
- the relative timing of the working capital insufficiency;
- an action plan to address the shortfall (including degree of confidence and timing); and
- the implications of the proposed actions being unsuccessful.

This will form the basis for the disclosures required by the relevant regulation that the directors will need to make in the investment circular in connection with the qualified working capital statement.

EVIDENCE AND DOCUMENTATION

a. Key elements of the process should be evidenced through contemporaneous documentation.

b. Sufficient documentary support should be obtained, including for the business analysis and plans, working capital projections, key assumptions, risk analysis, committed facilities and reasonable worst-case scenario.

c. The directors should formally document and approve the working capital statement and underlying PFI in the form of a board memorandum/paper (or in board minutes) covering the form of the published working capital statement, the basis for the statement, a summary of the working capital projections, key assumptions, headroom, sensitivities and conclusions reached by the directors.

Annex A: Statements of sufficiency of working capital in capital markets transactions

1. UK

1.1 Summary of UK regulation relating to working capital statements

PRR (which implement and incorporate the Prospectus Regulation and the Delegated Regulation), LR, AIM Rules and NEX Exchange Growth Market Rules require that in certain circumstances, an investment circular (prospectus, circular, admission document, etc.) contains a working capital statement.

Investment circulars requiring a working capital statement	Regulation Reference
For a prospectus containing a securities note for equity securities or units issued by collective investment undertakings of the closed-end type	Delegated Regulation Annex 11 Item 3.1
For a prospectus containing a securities note for secondary issuance of equity securities or of units issued by collective investment undertakings of the closed-end type	Delegated Regulation Annex 12 Item 3.3
For a prospectus containing a securities note for depository receipts issued over shares	Delegated Regulation Annex 13 Item 1.1
For a prospectus containing an EU Growth securities note for equity securities	Delegated Regulation Annex 26 Item 2.1
Premium listing of equity shares: Application by a commercial company (Note: LR6.1.1R contains exceptions such that this only applies to new applicants)	LR 6.7.1R (must be a clean statement)
Premium listing of equity shares: Class 1 disposal by companies in severe financial difficulty	LR 10.8.4 R (8)
Premium listing of equity shares: Class 1 transaction	LR 13 Annex 1R (as applied by LR 13.4.1R)
Premium listing of equity shares: Circular for reconstruction or refinancing	LR 9.5.12 R (3)
Premium listing of equity shares: Circular for purchase of >25% of own equity shares	LR 13.7.1 R (2) (f)
AIM Admission Document	AIM Rules paragraph (c) of Schedule Two (must be an unqualified statement)
NEX Exchange Admission Document	NEX Exchange Growth Market Rules - Admission of shares, Appendix 1 Table A Section 3 - Admission of debt securities, Appendix 1 Table B Item 3.1 NEX Exchange Growth Market: Practice Note on Working capital for issuers seeking admission
Migration to a premium listing	LR 5.4A
NOTE: LR 16.2.1R contains a dispensation for Premium Listing: Open-ended investment funds (there are no equivalent derogations in the Delegated Regulation, therefore working capital statements are required to be included in a document that is a prospectus subject to the Delegated Regulation).	

NOTE: Where an issuer is preparing a prospectus in addition to undertaking a significant acquisition, for the purposes of the prospectus it is not appropriate to include a working capital statement limited to an enlarged group basis. This is because it does not cover eventualities such as the acquisition not taking place. However, the issuer may wish to include a single PRR compliant working capital statement, which in a combined document would also satisfy the Class 1 LR requirements or, if the issuer prefers, two statements, one prepared on a PRR basis and one on an enlarged group basis.

1.2 Summary of regulatory guidance applicable to directors and/or advisers

ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (ESMA Guidance)	
Para 107-108	Definitions (Working Capital and Present Requirements)
Para 109-112	Introduction
Para 113-115	Clean working capital statements
Para 116-123	Qualified working capital statements
Para 124-126	Principles for preparing working capital statements

FCA Technical Notes and Procedural Notes	
FCA / TN / 320.1	Working capital statements - Basis of preparation
FCA / TN / 321.1	Working capital statements and risk factors
FCA / PN / 904.3	Public offer prospectus – Drafting and approval

1.3 Summary of other relevant regulation and guidance

Role of Sponsor: Premium Listing – LR	LR 8.4.2 R (5) – Application for admission LR 8.4.8 R (3) – Application for admission: further issues LR 8.4.12 R (3) – Class 1 circulars, refinancing and purchase of own equity shares LR 8.4.15 R (5) – Applying for a transfer between listing categories
Sponsor – FCA Technical Notes	FCA / TN / 704.3 – The sponsor's role on working capital confirmation FCA / TN / 705.2 – Sponsors: uncertain market conditions
Role of Nominated Advisers	AIM Rules for Nominated Advisers – Schedule Three (Nominated Adviser Responsibilities) – AR 3 Due Diligence

Reporting accountants	Standard for Investment Reporting 1000 – Investment reporting standards applicable to all engagements in connection with an investment circular (SIR 1000)
Competent Authorities	PRR Section 3.1.1 Article 38

1.4 Regulatory obligation – standards of care required

Capital markets regulation in the UK imposes standards on the content of information (including working capital statements) included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information including the following.

- The standard required by the LR is that the directors have a reasonable basis on which to make the working capital statement.
- The standard required by the AIM Rules is that the statement is made by the directors after 'having made due and careful enquiry'.
- In relation to a working capital statement contained in a UK prospectus for a premium listed company or a Class 1 circular, LR require that the issuer's sponsor confirms to the UKLA that they have come to a reasonable opinion, after having made due and careful enquiry, that the directors have a reasonable basis on which to make the working capital statement.
- In relation to an AIM admission, the nominated adviser has responsibility in relation to the working capital statement as part of its general consideration of the suitability of the AIM applicant. This entails assessing the extent to which the directors can demonstrate that they have undertaken appropriate procedures to support the statement being made and being satisfied that appropriate working capital procedures have been undertaken (this usually includes commissioning work in connection with working capital and obtaining applicable reports or letters from a reporting accountant).
- ESMA Guidance requires that in making the working capital statement to be based on robust procedures to limit the risk that the statement is called into question. Accordingly, issuers are expected to have undertaken appropriate procedures to support the statement being made.
- In addition, the LR (for Class 1 circulars), the PRR (for prospectuses) and the AIM Rules (for admission documents) require that a declaration is given by the directors in relation to the information contained in an investment circular that the information is, to the best of their knowledge, in accordance with the facts and the investment circular contains no omission likely to affect its import.

1.5 Example wording of clean working capital statement

1.5.1 Prospectus

'The Company is of the opinion that, [taking into account the net proceeds of the Offer], the Group has sufficient working capital for its present requirements, that is, for at least the next 12 months from the date of this Prospectus.'

1.5.2 AIM Admission Document

'The Directors are of the opinion having made due and careful enquiry that, [taking into account the net proceeds of the [Placing/Offer]], the Group has sufficient working capital for its present requirements, that is, for at least the next 12 months from the date of Admission.'

2. EU

2.1 Summary of EU regulation relating to working capital statements

The European Commission has established a requirement for companies making a public offer within the EU or seeking admission to a European regulated market to prepare a prospectus.

The Delegated Regulation specifies the contents of a prospectus:

Investment circulars requiring a working capital statement	Regulation Reference
For a prospectus containing a securities note for:	
Equity securities	Annex 11 Item 3.1
Units in a closed-end collective investment undertaking	Annex 12 Item 3.3
Depository receipts over shares	Annex 13 Item 1.1
Equity securities (EU Growth prospectus)	Annex 26 Item 2.1

2.2 Summary of regulatory guidance applicable to directors

ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (ESMA Guidance)	
Para 107-108	Definitions (Working Capital and Present Requirements)
Para 109-112	Introduction
Para 113-115	Clean working capital statements
Para 116-123	Qualified working capital statements
Para 124-126	Principles for preparing working capital statements

2.3 Summary of other relevant regulation and guidance

Competent Authorities	Delegated Regulation Article 38

2.4 Regulatory obligation – standards of care required

The Prospectus Regulation imposes standards on the content of information (including in relation to working capital statements) included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information including:

- the standard required by the Prospectus Regulation is that the directors ensure that, to the best of their knowledge, the information contained in the investment circular is in accordance with the facts and the investment circular contains no omission likely to affect its import; and
- the ESMA Guidance requires that in making the working capital statement there is very little risk that the basis of such a statement is subsequently called into question. Accordingly, issuers are expected to have undertaken appropriate procedures in preparing PFI to support the statement being made.