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Cash in the Net Working Capital Calculation and Adjustment

By David Musen on August 5, 2026

Competent transactional attorneys all understand the basics of a net working capital adjustment. A Buyer does not want to be faced with the need to infuse additional capital into a company that they just purchased at a fixed enterprise value for the business as a going concern, so as part of the transaction they work with the Seller to determine the amount of working capital (a normalized level of current assets less current liabilities) a Buyer would expect to find in the company at any given time (the "**Peg**") and then measure the actual working capital of the Company as of the Closing against that Peg. If the actual amount is less than the Peg, the Seller must fund the shortfall, usually paid out of a holdback or escrow imposed under the purchase agreement. If the business has more working capital than the Peg, the Buyer pays (or releases from the escrow/holdback) the overage to the Seller. Nobody wins or loses and everyone receives the value of what they bargained for.

However, even the most seasoned practitioners can sometimes get hung up on what to do with the cash element of working capital. Letters of intent (LOI) routinely include in big, bold lettering language to the effect that this deal will be a "**debt-free, cash-free transaction**" (DFCF). This is generally accepted to mean that the Buyer will take the assets/equity of the Seller without debt, and the Seller will leave no cash or cash equivalents in the company accounts as of the Closing Date. Indeed, despite standard accounting methodology treating cash as a current asset, operating cash is typically excluded from working capital definitions. Instead, the Buyer and Seller will look to the current assets of the company that can be converted into cash within a certain time period (often a year), including accounts receivable, inventory and other operating assets. Doing so makes sense for several reasons:

- Net working capital (NWC) is designed to measure operational liquidity: the capital tied up in the day-to-day cycle of the business. Cash held in excess of what the business needs to operate does not belong in that measure. Including it would cause the NWC calculation to fluctuate based on the Seller's pre-close cash management decisions rather than reflecting the underlying operational health of the business. After all, a business with $10 million of cash on its balance sheet and a business with no cash, all else being equal, have the same enterprise value if that cash is simply sitting idle
- Cash tends to be more stable and specific to each business' operations, such as industrial operators establishing cash reserves for capital expenditures, or retailers maintaining minimum amounts of cash in their cash registers.
- Accounting for cash would add increased complexity to the determination of what is a normalized level of current assets, raising important questions about what level of cash is required for operations versus surplus cash. A Buyer would obviously want the former to be a much higher figure, whereas a Seller would argue that most of the cash on hand is

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indeed surplus. After all, there is always more cash coming in the door as accounts receivable are collected.

And yet, in practice, almost no transaction these days involves a Seller leaving a business completely devoid of cash at the closing. Indeed, were the DFCF language from the LOI to be taken at face value, the Buyer would receive a business without the liquidity cushion necessary to operate from day one. Practitioners usually undertake one of two approaches to resolving this drafting tension created by a perhaps unartfully drafted LOI.

- The parties agree to include minimum cash in the NWC target.
  1. Under this approach, the Peg is set at a level of NWC that includes a normalized cash balance — reflecting the average cash the Seller has historically carried in the ordinary course of business. The Seller is expected to deliver that level of cash as part of NWC at closing, and remove from the entity accounts any cash above the embedded balance. This approach is conceptually clean and aligns the Peg with how the business has actually been run. On the other hand, doing so requires the parties to agree on what "normalized" operating cash looks like, which can itself become part of a protracted negotiation.
  2. Sellers must be cautious about this approach, because if minimum cash is included in the Peg but swept out at closing via the DFCF mechanism or sweep**[1]**, the Seller is effectively leaving that cash behind without receiving credit for it. They are not being paid for it through the sweep and they are not being paid for it through NWC because the Peg assumed it would be there. The result is a silent purchase price reduction that never gets explicitly negotiated.

- Alternatively, the parties can agree to exclude cash from NWC entirely, but set a cash floor.

Under this approach, cash is carved out of NWC entirely — consistent with the terms of the LOI — but the purchase agreement specifies a minimum cash amount that the Seller must leave in the business at closing. Cash above the floor is swept; cash below the floor results in a dollar-for-dollar purchase price reduction. This approach is more transparent but adds a separate moving part to the closing mechanics.

In this scenario, if minimum cash is excluded from the Peg and also excluded from the DFCF sweep — meaning the Seller is required to leave it in the business and the Peg is calibrated accordingly — then the Seller must be paid for it through the either an increase to the enterprise value with the assumption that the business operates with that cash base, or as an upward adjustment to the purchase price for the business.

However, there are concerns that the Buyer may have that must be addressed. For example, what is the Seller supposed to do with current accounts receivable as they move towards closing? Is there anything to prevent them from going to their customers and telling them to maybe (wink-wink, nudge-nudge, say no more) make payments to the Seller that would otherwise be payable net thirty (30) days post delivery of services or goods the day after receiving their invoice when the closing is 2 weeks away? How do you make sure what amount of inventory Seller must maintain "in the ordinary course" prior to Closing to make sure the Buyer isn't stepping into the shoes of effectively a shell entity?

Under either approach, even seasoned attorneys can get caught in small drafting errors with large consequences for their clients' bank accounts. For example, cash can get counted twice when a cash balance is both swept out under the DFCF mechanism and simultaneously reflected as a current asset in the NWC calculation. If cash is included in the Peg — meaning the Peg was set at a level that assumed cash would be present — but that same cash is also removed via the DFCF sweep, the Seller has effectively been charged for delivering cash they were never supposed to leave behind. A $2 million minimum cash balance embedded in the Peg, left unaddressed, translates directly into a $2 million reduction in what the Seller walks away with — not because the deal economics justified it, but because the mechanics were not carefully aligned.

The reverse problem is less common but equally real: a situation where cash is excluded from the DFCF sweep because it was characterized as "operational" or embedded in NWC, but the Peg was set on a cash-excluded basis, meaning the Buyer receives the cash for free without any corresponding purchase price credit to the Seller.

Conclusion:

The treatment of cash in a net working capital adjustment is deceptively simple in concept but unforgiving in execution. The standard "debt-free, cash-free" framing in an LOI is a useful shorthand, but it is rarely the operative reality once the parties turn to drafting definitive documents. Every deal needs some cash left in the business to keep the lights on and someone has to decide how much, who pays for it, and through which mechanism.

What the analysis above makes clear is that there is no single "correct" approach — whether the parties build a normalized cash balance into the Peg or instead exclude cash entirely and impose a separate minimum cash floor, either structure can work if it is implemented consistently. The real risk is not the choice of methodology, but internal inconsistency between the NWC definition and the DFCF/sweep mechanics. Cash embedded in the Peg but also swept at closing effectively strips value from the Seller without any offsetting credit; cash excluded from the sweep but not accounted for in the Peg does the opposite, handing the Buyer a windfall. In both cases, the dollar consequences are direct and can be substantial, yet they often arise not from any deliberate negotiating position but from misaligned drafting across different sections of the purchase agreement.

Attorneys on both sides should therefore treat cash as its own discrete negotiating point — not an afterthought to the broader NWC mechanism — and should stress-test the purchase agreement's defined terms (Peg, NWC, Closing Cash, Permitted Cash, Sweep) against one another to confirm they tell a single, coherent story. Equally, Buyers should anticipate and address the incentive issues that arise as a seller approaches closing — from accelerated receivable collection to depleted inventory — since these behaviors can distort the very NWC and cash figures the deal is designed to protect. It is also a worthwhile exercise to attach a sample calculation of net working capital using the Seller's own accounting line items to ensure that the parties' are aligned given the complexities and potential interpretation of DFCF. A carefully calibrated cash mechanism, cross-checked line by line against the rest of the purchase price adjustment provisions, is the only reliable way to ensure that the economic bargain struck in the LOI survives intact through signing and closing.

[1] A DFCF mechanism or "sweep" is mechanical adjustment made at closing that removes both financial debt and excess cash from the transaction in order to convert an agreed enterprise value into a final equity value payable to the Seller. The sweep is typically applied as a simultaneous set of adjustments at closing, so that the final wire transfer to the Seller reflects enterprise value, minus debt, plus cash — delivering an equity value that corresponds precisely to the operating business the Buyer is acquiring.

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